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IN THE

Supreme Court of the United States

OCTOBER TERM 1968

No. 1183

ELECTRONIC SYSTEMS INVESTMENT CORPORATION,

Petitioner,

v.

SMALL BUSINESS ADMINISTRATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT.

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IN THE

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ELECTRONIC SYSTEMS INVESTMENT CORPORATION,

Petitioner,

v.

SMALL BUSINESS ADMINISTRATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT.

Electronic System Investment Corporation prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, entered in this case on November 19, 1969.

OPINIONS BELOW

The opinion of the United States Court of Appeals is printed in Appendix A hereto, Pages A–1, and is reported at 405 F.2d 188.

The Initial Decision of the Hearing Examiner before the Small Business Administration is printed in Appendix B hereto, Pages 1-39.

The Order of the Small Business Administration reviewed by the United States Court of Appeals is printed in Appendix B hereto, Pages 1-6.

JURISDICTION

The judgment of the United States Court of Appeals for the Fourth Circuit was entered on November 19, 1968. Justice Byron S. White, on February 17, 1969, issued an order extending the time to file a petition for writ of certiorari to and including March 19, 1969.

Title 28, United States Code, Section 1254 (1) confers on this Court jurisdiction to review the judgment of the United States Court of Appeals for the Fourth Circuit.

QUESTIONS PRESENTED

Did the United States Court of Appeals for the Fourth Circuit commit error by failing to set aside the Order of the Small Business Administration on the grounds, among others, that:

A. There was no legal justification for the drastic Order suspending Electronic Systems Investment Corp., until it divests its entire financing of Technical Animations, Inc., in the light of the controlling findings of fact.

B. That there was a denial of due process in the hearing held on the Order to Show Cause inasmuch as the Small Business Administration made but one person available to give testimony and he was not one of the officials who had first hand knowledge of the facts and with whom petitioner principally had dealings.

STATUTES AND REGULATIONS INVOLVED

The following statutes and regulations are involved, the text of which, to the extent pertinent, have been printed in Appendix E.

A. The Small Business Investment Act of 1958 as Amended, 15 U.S.C. § 661 *et seq.* App. E-1 (§ 306 and § 309)

B. Excerpts from SBA Rules and Regulations (§ 107.708 (App. E-3 (§ 107.716) App. E-3.

C. Excerpts from Administrative Procedure Act now found in 5 U.S.C. § 500 *et seq.*, App. E-4 (§§ 577,558)

STATEMENT OF THE CASE

This case comes before the Court to review the decision of the United States Court of Appeals for the Fourth Circuit, affirming an Order of the Small Business Administration (SBA) which: (1) required petitioner to divest itself of certain financing; (2) suspended petitioner from acting as a small business corporation; and (3) required petitioner to cease and desist violating certain provisions of the Small Business Administration Act and regulations issued thereunder, which, it was alleged, petitioner had violated.

Originally a Show Cause Order was issued by the Small Business Administration (SBA) on September 21, 1966. Thereafter, hearings were held on this Show Cause Order on April 24 and 25, 1967. At the conclusion both parties submitted proposed findings of fact, conclusion of law and briefs. The Hearing Examiner issued his decision on June 22, 1967 dismissing the Order to Show Cause in its entirety.

Whereupon the Staff attorney for SBA filed with SBA a petition to review and reverse the Examiner's determination,

which was granted by the SBA Administrator, who then reviewed the Initial Decision of the Hearing Examiner. The Administrator made no new findings of fact and did not challenge the Examiner's findings of fact as such. These findings are the controlling findings in this case. The Administrator, however, reversed the Hearing Examiner's conclusions of law, and issued his own "Opinion–Cease and Desist and Suspension Order" on February 5, 1968 (App. C-1–6). Petitioner then filed a petition with the United States Court of Appeals for the Fourth Circuit to review the determination of the Administrator and to set aside his Order. Petitioner also moved the Administrator to stay the effective date of his Order pending review thereof, but he refused to grant this motion.

The Court of Appeals on November 19, 1968 rendered a Per Curiam opinion affirming the Order of the Administrator and denying the petitioner's petition to set aside the Administrator's Order (App. A).

REASONS FOR GRANTING A WRIT

The questions here involved are important in the administration of the Small Business Administration for if the determination of the United States Court of Appeals for the Fourth Circuit, denying the petition of the Electronic Systems Investment Corporation to set aside the Order of the Small Business Administration, is not reversed, (1) administrative procedural law will be set back to the low standards that existed in certain areas of federal administration before the Administrative Procedure Act was passed to correct the abuses that existed in the federal machinery for administering laws passed by Congress and (2) petitioner will be forced out of business and, quite likely, other similarly existing companies, operating under the provisions of the Small Business Administration Act, will also be forced out of business.

ARGUMENT

A. Certiorari Should Be Granted to Determine Whether, as Petitioner Contends, the Small Business Administration Order Was Clearly Erroneous and in Conflict With the Detailed, and Fully Supported, Findings of Fact of the Hearing Examiner

While an administrative board may draw different conclusions from facts found by a hearing examiner, yet such findings, as in this case, should not be ignored. This Court pointed this out in *Universal Camera Corp. v. National Labor Relations Board,* 340 U.S. 474, 71 S. Ct. 456, 95 L. Ed. 456 (1951). It was held that a court in reviewing an examiner's findings, should give to such findings the relevance they reasonably command in the light of reason and judicial experience in considering the question of whether the evidence supporting the order of a board is substantial.

In the *Universal Camera Corp.* case, both provisions of the Taft-Hartley Act (61 Stat. 139, 29 U.S.C. § 141 *et seq.*) and the Administrative Procedure Act (60 Stat. 237, § USCA § 1001 *et seq.*) were considered in the light of the facts involved. The Court in referring to the Administrative Procedure Act, applicable to this case, said (340 U.S. at pages 496-497, 71 S. Ct. 469):

> "We do not require that the examiner's findings be given more weight than in reason and in the light of judicial experience they deserve. The 'substantial evidence' standard is not modified in any way when the Board and its examiner disagree. We intend only to recognize that evidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn conclusions different from the Board's than when he has reached the same conclusion. The findings of the examiner are

> to be considered along with the consistency and inherent probability of testimony. The significance of his report, of course, depends largely on the importance of credibility in the particular case. To give it this significance does not seem to us materially more difficult than to heed the other factors which in sum determine whether evidence is 'substantial'."

As previously stated, the Administrator did not base his conclusions upon the facts as found by the Hearing Examiner, but upon such nebulous things as "the pattern of behavior" (App. C.43, par. 4 "the past and present conduct" of petitioner (App. C.42, par. 3). The Hearing Examiner in this case was experienced and impartial. He, and he alone, observed the witnesses, listened to their testimony and made findings of fact accordingly and drew sound conclusions therefrom.

The Hearing Examiner paraphrased the countsof the Order to Show Cause and related matters as follows (App. B. 3, B. 4):

> "The order to show cause contains five counts, three alleging violations of the conflict-of-interest regulation and two alleging violations of the limitation on aggregate investment – so-called "overline" financing. The transactions, all alleged to have been consummated without SBA approval, are briefly as follows:
>
> > Count I: Investment of $59,400 in Cablevision of Fredericksburg, Inc. ("Cablevision"), at a time when H. M. Kannee (an officer, director and 44% stockholder of respondent) was an officer and director of Cablevision, and his wife and her sister owned 600 shares, or over 10%, of Cablevision's outstanding stock.
> >
> > Count II: Loan of $60,000 to Famor, Inc. ("Famor") at a time when Kannee was a director of Famor.

Count III: Loans of $15,000 to and investment of $66,000 in Technical Animations, Inc. ("TAI") At times when G. H. Bookbinder (president, director and 44% stockholder of respondent) was a director of TAI.

Count IV: An overline loan to Cablevision which brought the total investment therein to $94,200 and caused it to exceed the limitation of 20% of respondent's "statutory capital" of $301,000.

Count V: An overline loan of $10,000 to Ridgecrest Condominium Corp. ("Ridgecrest"), in addition to previous loans aggregating $80,675 which included an earlier overline loan approved (but only to the extent of such earlier overline loan) by SBA.

The order to show cause further alleges that by letter of August 29, 1966, SBA notified respondent of its "failure to operate within the purview of the Act and Regulations" as alleged, and requested "corrective action" to be taken within 15 days; and that respondent failed to comply within 15 days after receipt of the letter and still fails to do so. The order to show cause was served on or about September 21, 1966.

In general, respondent admits the transactions but denies any violation of the Act or Regulations, for reasons set forth hereinafter in the statement of facts and discussion."

The findings of fact as to each of these counts are set forth in the Hearing Examiner's Initial Decision (App. B. 4-22) and the same are discussed in detail and conclusions of the Examiner are clearly stated (App. B. 23-39).

The Order of the Administrator, which was subject to review and was appealed, related to but one of the five counts listed above, namely, Count III, the alleged loan of $15,000, and investment of $66,000 in Technical Animation, Inc. ("TAI"). Everything else stated in the Order was a generalized statement that petitioner shall "cease and desist from violating the provision of Sections 306 of the Act and Sections 107.708 and 107.716 of the SBA Regulations" and that petitioner should submit a written report of its compliance with the Order within 60 days.

The specific issues subject to review by the Court below, covered but two paragraphs of the Order of SBA which reads as follows (App. C.5, 6):

> "AND IT IS HEREBY ORDERED THAT: The Respondent, ELECTRONIC SYSTEMS INVESTMENT CORPORATION, shall, within sixty days (60) after the effective date of this Order, divest from its portfolio all of its financings to TECHNICAL ANIMATIONS, INC.
>
> "IT IS FURTHER ORDERED that the license of the Respondent, ELECTRONIC SYSTEMS INVESTMENT CORPORATION, be suspended, and the suspension to remain in effect until the Respondent divests the entire financing to TECHNICAL ANIMATIONS, INC., from its portfolio. While the Respondent's license is suspended, it shall not operate as a small business investment company nor shall it receive privileges of a complaint Licensee. This Order shall not prohibit ELECTRONIC SYSTEMS INVESTMENT CORPORATION from maintaining its present operational overhead and making collection upon debts due said Licensee."

The determination of the Administrator, as stated in the above Order, was not supported by the findings of fact of the Hearing Examiner or, it may be added, by the Administrator's

own statements. It cannot be over-emphasized that the Administrator was in no position to make any independent findings of fact and it goes without saying that the basis of any valid Order issued by the Administrator had to be bottomed on proper findings of fact. In this case, the findings of the Hearing Examiner, most judicially determined and stated, do not in any way support the Administrator. For the Hearing Examiner stated, with reference to –

Count III –TAI (Technical Animations Inc.) Financing

(1) This matter was first completely disclosed to SBA by [Petitioner] ESIC (App. B.13 – top page, line one).

(2) There was no substantial conflict of interest at all, a fact which SBA seems never to have considered (App. B. 30, last sentence, 1st para.)

(3) The first short term loans totalling $15,000 were repaid leaving a profit to ESIC of 6000 shares of TAI stock (App. B. 14, line 7, para. 1).

(4) The matter of the short term loans of $15,000 had been resolved satisfactorily to SBA (App. B. 17, line 5, second full para.)

(5) The regulation claimed to have been violated is not so clear as to indicate that ESIC's interpretation was not adopted in good faith (App. B. 27, line 6, 1st full para.)

(6) The regulation is less than clear (App. B. 27, *Ibid.*)

(7) ESIC Participated with two other SBIC's in equity financing of TAI and Bookbinder became one of the six directors elected to the board to protect the investment precisely as contemplated by the regulation (App. B. 30, 1st para., 2nd sentence).

(8) It is clear that Bookbinder could not be required to give up this directorship and in fact, he did not (App. B. 30, next to last line 1st full para.)

(9) The TAI "affiliation" would undoubtedly have been approved by SBA as a matter of course upon a prior application, since there was no substantial conflict of interest at all (App. B. 30, last sentence, 1st para.)

(10) Failure to obtain prior approval of SBA was a violation of the regulation even though insubstantial (App. B. 31, top page).

(11) The violation was merely technical and not willful because ESIC believed in good faith that the exception in the regulation applied when there was in fact no substantial conflict of interest and the purpose of the regulation was being served (App. B. 31, 1st full para.)

(12) In the Berwyn-Hartwick matter where there was in fact a substantial conflict of interest, ESIC requested and received approval in accordance with the regulation (App. B. 31, last sentence, 1st full para., 1st sentence.)

(13) It was not a repeated violation (App. B. 31, 2nd full para.)

(14) SBA refused to approve the TAI financing retro-actively or to waive the application of its regulations, after suggesting that ESIC request it to do so (App. B. 31, last para.)

(15) Instead it in effect demanded that the baby be thrown out with the bath by insisting that ESIC divest itself of the financing. Such a remedy is not reasonable in relation to the violation (App. B. 32, line 3 from top.).

(16) The financing itself does not violate the Act or Regulations, since there is in fact no detrimental conflict of interest (App. B. 32, line 6.)

(17) Divestiture is not necessary to expunge a continuing violation, for there is no continuing violation (App. B. 32, line 11).

(18) Divestiture is unnecessarily drastic, and tends to defeat, rather than further, the purpose of the Act. (App. B. 32, line 18).

(19) There is no real conflict of interest, notwithstanding a technical violation of a regulation whose only purpose is to discover and achieve control of such conflicts (App. B. 32, last line).

(20) To require Bookbinder's resignation would clearly be contrary to the purpose of the regulation (App. B. 33, line 4, 1st full para.)

(21) There is no existing interest within the contemplation of the regulations which need be eliminated (App. B. 33, last sentence, 2nd para.).

(22) ESIC did not willfully commit the technical violation and it is safe to assume that ESIC's experience in these proccedings will make it more responsive to regulation in the future (App. B. 33, 1st sentence, 2nd full para.).

(23) At present, to require divestiture of the financing is inappropriate, unwarranted and unnecessary (App. B. 33, para. 2, last line; App. B. 38, line 5 from top).

(24) No conflict of interest (self-dealing) existed or now exists with respect to such financing which might be detrimental to any small business concern, to any small business investment company, to the share-holders of either, or to the purposes of the Act (App. B. 38, line 1 from top).

B. There Is No Legal Justification Whatsoever for Putting Out of Business a Small Business Investment Corporation by Suspending Its License When But One Investment Is Ordered To Be Divested and, As of the Date of the Promulgation of Said Order, Was Not Even a Technical Violation of the Law.

Of all the investments of petitioner but one was singled out by the SBA Administrator in his Order to be divested, namely, the financing of Technical Animations Inc. which, at the very time the Order of the Administrator was promulgated, was no longer even a technical violation. Here is what the Hearing Examiner held with respect to this matter as his "Ultimate Conclusion" (App. B. 37), based upon his findings of fact:

> "3. Respondent violated Section 107.716 of the SBA Regulations in connection with the financing of Technical Animations, Inc. as alleged in Count III of the said Order to Show Cause: However, said violation was neither willful nor repetitive; no conflict of interest existed or now exists with respect to such financing which might be detrimental to any small business concern, to any small business investment company, to the shareholders of either, or to the purposes of the Act; there is no continuing violation of the Act or regulations or of the policy of either; and the divestiture pursuant to order of the SBA of respondent's existing investment in the stock of Technical Animations, Inc. is unnecessary and unwarranted.

The Administrator's Opinion and Order with regard to Count III contains the following:

(1) *"Respondent made two loans to Technical Animations, Inc. (TAI) and one investment in its common stock."* (App. C-1).

This was not a new finding. The Hearing Examiner made a finding as to the loans. (App. B-12, B-13, B-17).

(2) "*At the time of each of these loans George Bookbinder was a director of TAI and president and owner of 44 percent of the outstanding stock of Respondent.*" (App. C-1, C-2).

The Examiner had already made a finding on the same matter in these words (App. B-12)

"Meanwhile, in May and June 1965, respondent [petitioner here] had made two short-term loans aggregating $15,000 to Technical Animations, Inc. (hereinafter 'TAI'), a corporation of which Bookbinder had been a director since 1962, and in which he held a small (less than 1%) stock interest as well as $1000 of its $212,500 outstanding debentures."

At another place (App. B-30) the Hearing Examiner made a finding that when petitioner participated with two other small business investment companies in equity financing of TAI Bookbinder became one of the six directors elected to the board to protect the investment "precisely as contemplated by paragraph (h) of Section 107.716 of the regulations. . . [and] . . ." it is clear that Bookbinder could not have been required to give up this directorship, and in fact he did not".

(3) "*Although required to do so under Section 107.716 of Regulations, Respondent [petitioner here] neither sought nor received prior written approval from SBA for these transactions*" (App. C-2)

The Hearing Examiner, while agreeing that the failure to receive prior written approval was a violation of the regulation (App. B-31) then stated (App. B-31):

"It is found not to have been a willful violation, however, because respondent

[petitioner here] believe, in good faith though erroneously, that the exception contained in paragraph (h) of Section 107.716 applied when there was in fact no substantial conflict of interest and the purpose of paragraph (h) was being served, notwithstanding prior existence of the directorship."

(4) *"The 'TAI' financing violated Section 107.716 of the SBA Regulations and a conflict of interest still exists with respect to this financing, as Bookbinder is still a director of 'TAI'"* (App. C-2).

The findings of the Hearing Examiner with respect to this matter is referred to under (2) and (3) above and will not be repeated here. The Administrator's observations are repeated with but slight variation in both paragraph "3" and "4" of the "Opinion-Cease and Desist and Suspension Order" (App. C-4).

(5) *"The Hearing Examiner erred in finding that the prohibited financing of Technical Animations, Inc. is not a continuing violation"* (App. C-2)

The findings of the Hearing Examiner and his conclusions with respect to this matter are fully supported in the record and the Administrator's determination is not so supported. The Examiner found (App. B-32) that:

"The financing itself does not violate the Act of Regulations, since there is in fact no detrimental conflict of interest. The violation was in entering into the financing

without the prior approval required by the existence of a common directorship, a situation which does not of itself make the *financing* illegal. Here, divestiture is not necessary to expunge a continuing violation, for there is no continuing violation." (Italics in original)

(6) "*Respondent neither requested nor received permission from SBA to make such excess financing.*" (App. C-2).

This is a repetition of the statement quoted in (3) above. The findings of the Hearing Examiner there quoted is equally applicable here.

It will be seen from the foregoing that the Order of the Small Business Administration with respect to the single specific issue involved in its determination, namely, that (App. C-6) petitioner here "*shall, within sixty days (60) after the effective date of this Order, divest from its portfolio all of its financings to TECHNICAL ANIMATIONS, INC.*" rests, if at all, upon the thinnest of thin grounds, certainly not an issue to bottom a drastic Order such as SBA promulgated in suspending petitioner's license to operate until it "divests the entire financing to TECHNICAL ANIMATIONS, INC. from its portfolio."

The Small Business Administration should not be permitted to be so irresponsible and arbitrary in its operations and petitioner is looking to this Court to review this matter by granting the writ prayed for since the Court below erred in failing to set aside the Order of the Small Business Administrator on the grounds, among others, that the same was not supported by substantial evidence on the record considered as a whole.

C. Administrative Agencies Should Not be Permitted to Block a Petitioner's Effort To Secure Testimony, Important to Their Cause, From Agency Officials With Whom They Dealt and Who, Therefore, Have First Hand Information As To the Fact of the Case

One cannot read the detailed findings of fact of the Hearing Examiner in this case without becoming aware of the difficult plight of the petitioner to satisfy the various officials of SBA who were in and out of the case administratively. The following names are mentioned in the Hearing Examiner's findings of fact: Mr. Wicker (App. B-5); Mr. MacKinnon (App. B-5); Mr. John B. Morris (App. B-5); Mr. "Dick" Kelley (App. B-6); Mr. J. T. Phelan (App. B-9); Mr. Leisy (App. B-13); Mr. Bender (App. B-15); Mr. Lawrence F. Friess (App. B-19); and Mr. Greenberg (App. B-20).

Of all of these men SBA allowed only one witness to testify, namely, Mr. Friess. This official had no personal knowledge of the transaction charged as violations. He operated in the Rocky Mountain area which was his responsibility (Tr. 47). He testified that from the time he began his employment at SBA he had nothing to do with petitioner or the area in which it operated (Tr. 48) and that his testimony was based only on examination of the records.

This was a frustrating experience. Those who were principally involved on the policy making level would not submit to interrogation. One can only surmise that they felt the charges made could not stand up under a searching cross examination.

It is submitted that this method of operating by SBA is a denial of due process and contrary to the Administrative Procedure Act (5 U.S.C. 500 *et seq.* App. E-).

CONCLUSION

For the above stated reasons, it is respectfully submitted that the petition for a writ of certiorari be granted.

Respectfully submitted,

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Counsel for Petitioner

APPENDIX A

[Filed November 19, 1968]

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 12,223

Electronic Systems Investment Corporation,

Petitioner,

vs.

Small Business Administration,

Respondent.

On Petition for Review of an Order of the Small Business Administration.

(Argued October 30, 1968 Decided November 19, 1968.)

Before Sobeloff and Bryan, Circuit Judges, and Hutcheson, District Judge.

Fredric T. Suss for Petitioner, and William Kanter, Attorney, Department of Justice (Edwin L. Weisl, Jr., Assistant Attorney General and Morton Hollander, Attorney, Department of Justice, on brief) for Respondent.

PER CURIAM:

Under the Small Business Investment Act, of 1958, as amended, 15 USC 661, 687a(c), the Administration issued an order on September 21, 1966 requiring Electronic Systems Investment Corporation, chartered in Maryland, to show cause why its license as a small business investment company under the Act should not be suspended for, and the corporation directed to cease and desist from, violating the Act, 15 USC 686, and the Administration's regulations, 13 CFR 107.708, 107.716. The breaches laid to Electronic were infractions (1) of those provisions of the Act and the regulations prohibiting, without prior written approval of the Administration, the providing by the investment company of an aggregate of more than 20% of its paid-in capital and surplus, to a single business concern; and (2) infraction of the regulation prohibiting, without such approval, the financing by an investment company of another company which has a common director with the investment company.

After a hearing, the charges were ultimately upheld by the Administration. An order was entered on February 5, 1968 by the Administration directing the investment company to cease and desist from further violation of the Act and the regulations, directing it to divest itself of the alleged illegal financings and suspending its license pending obedience to the order.

This appeal is now taken by Electronic attacking the Administration's order as unwarranted by the evidence and under the law. 15 USC 687a(e). On review of the record we cannot say the directive is without substantial proof or is contrary to law. Universal Camera Corp. v. N.L.R.B., 340 US 474 (1951). Accordingly, we deny the petition of Electronic to set aside the Administration's rulings.

Petition denied.

APPENDIX B

United States of America

Before The
Small Business Administration

Docket No. 67-30

In the Matter of
Electronic Systems Investment Corporation
License No. 03/04-0048

Fredric T. Suss for respondent.

John J. Sharp for the Small Business Administration.

INITIAL DECISION OF WALTER T. SOUTHWORTH, HEARING EXAMINER

The Small Business Administration (hereinafter "SBA") initiated this proceeding pursuant to Section 309(c) of the Small Business Investment Act of 1958 (hereinafter "the Act"), 15 USC 687a(c), by order to show cause dated September 21, 1966. The respondent, Electronic Systems Investment Corporation (hereinafter sometimes called "ESIC"), is a Maryland corporation duly licensed as a small business investment company ("SBIC") under the Act. The order directs respondent to show cause why an order should not be issued (1) determining that respondent has violated Section 306 of the Act (15 USC 686) and Sections 107.708 and 107.716 of the SBA Regulations (13 C.F.R. 107.708 and 107.716), (2) requiring respondent to cease and desist from continuing to violate the Act and Regulations, and (3) suspending respondent's license.

The statute and regulations alleged to have been violated have to do with (1) a 20% limitation on the percentage of its capital (as defined) which any SBIC may, without prior SBA approval, invest in any single enterprise (Sec. 306[1] of the Act; Section 107.708[2] of the Regulations); and (2) the control of conflicts of interest by prohibitions against investments in enterprises having certain connections or affiliations with the SBIC (through common or closely related directors, officers, stockholders, etc.) without prior SBA approval (Section 107.716[3] of the Regulations).

---

[1] Sec. 306 of the Act provides, under the heading "Aggregate Limitations":

> Sec. 306. Without the approval of the Administration, the aggregate amount of obligations and securities acquired and for which commitments may be issued by any small business investment company under the provisions of this Act for any single enterprise shall not exceed 20 per centum of the combined capital and surplus of such small business investment company authorized by this Act.

[2] The pertinent portion of Section 107.708 of the Regulations (13 C.F.R. 107.708) provides:

> § 107.708 Investment and loan limits.
>
> (a) *Size of investments and loans.* Without the prior written approval of SBA, the aggregate amount of funds loaned to, or invested in Equity Securities of, any single small business concern, or for which commitments may be made, shall not exceed twenty percent of the combined paid-in capital and paid-in surplus of any Licensee (including in such Licensee's capital and surplus the outsanding amount of any SBA loans and commitments under § 107.301).

[3] Section 107.716 of the Regulations (13 C.F.R. 107.716) provided, in pertinent part, with respect to transactions consummated prior to Feb. 15, 1965, as follows:

> (a) Self-dealing to the prejudice of SBA or the Licensee's shareholders is prohibited.
>
> (b) Without the prior written approval of SBA, a Licensee shall not purchase Equity Securities of, or make a loan to, an officer or a director of the Licensee, or any person owning or controlling, directly or indirectly ten or more percent of the stock of said Licensee, or any close relative of such officer, director, or stock owner or controller, nor shall the Licensee purchase Equity Securities of or make a loan to any company in which such officer or director or such owner or controller of

The order to show cause contains five counts, three alleging violations of the conflict-of-interest regulation and two alleging violations of the limitation on aggregate investments — so-called "overline" financing. The transactions, all alleged to have been consummated without SBA approval, are briefly as follows:

Count I: Investment of $59,400 in Cablevision of Fredericksburg, Inc. ("Cablevision"), at a time when H. M. Kannee (an officer, director and 44% stockholder of respondent) was an officer and director of Cablevision, and his wife and her sister owned 600 shares, or over 10% of Cablevision's outstanding stock.

Count II. Loan of $60,000 to Famor, Inc. ("Famor") at a time when Kannee was a director of Famor.

Count III. Loans of $15,000 to and investment of $66,000 in Technical Animations, Inc. ("TAI") at times when G. H. Bookbinder (president, director and 44% stockholder of respondent) was a director of TAI.

Count IV: An overline loan to Cablevision which brought the total investment therein to $94,200 and caused it to exceed the limitation of 20% of respondent's "statutory capital" of $301,000.

Count V: An overline loan of $10,000 to Ridgecrest Condominium Corp. ("Ridgecrest"), in addition to

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the Licensee's stock or his close relative is an officer or director or owns or controls ten or more percent of the stock of such company: *Provided, further,* That without the prior written approval of SBA a Licensee shall not make such purchase of such securities or make such loan within six months after the termination of such officership or directorship in the Licensee, or within six months after the termination of such ownership or control of ten or more percent of the Licensee's stock. Nothing herein contained is intended to preclude a Licensee from permitting an officer, employee or representative from serving as a director, officer, or in any other capacity in the management of a small business concern for the purpose of protecting its investment in or loan to such concern.

Effective February 15, 1965, the regulation was changed substantially, particularly in form. Changes which are pertinent to the transactions in issue are described hereinafter.

previous loans aggregating $80,675 which included an earlier overline loan approved (but only to the extent of such earlier overline loan) by SBA.

The order to show cause further alleges that by letter of August 29, 1966, SBA notified respondent of its "failure to operate within the purview of the Act and Regulations" as alleged, and requested "corrective action" to be taken within 15 days; and that respondent failed to comply within 15 days after receipt of the letter and still fails to do so. The order to show cause was served on or about September 21, 1966.

In general, respondent admits the transactions but denies any violation of the Act or Regulations, for reasons set forth hereinafter in the statement of facts and discussion.

The Facts

Respondent applied to SBA to be licensed as an SBIC some time prior to February 4, 1964; as of that date the application was "in the final stage," its proponents having established a bank deposit of $155,000 representing the paid-in capital and surplus with which the corporation was to commence business. Its officers, directors and stockholders (the proponents) were as follows:

George Bookbinder — President, Director and 44% stockholder

Henry M. Kannee — Secretary-Treasurer, Director and 44% stockholder

Allen M. Wolpe[4] — Vice President, Director and 6% stockholder

Donald E. Wolpe — Director and 6% stockholder

The proponents were looking into prospective investment situations for some time prior to receipt of the SBIC

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[4] Donald Wolpe was originally Vice President, but he resigned and his brother Allen Wolpe was elected Vice President prior to July 7, 1964. Otherwise the facts set forth obtained at all times from the date of licensing to the present.

license. One of these was Cablevision, which had been incorporated in August, 1963, by a friend and former business associate of Kannee's, one McGeehan, to build and operate a community antenna television system ("CATV") in Fredericksburg, Virginia. Kannee had been Secretary-Treasurer and a director of Cablevision since September, 1963, and in October, 1963, his wife and her sister had acquired 600 shares of its stock, at $5 per share, in partial discharge of a loan they had made to McGeehan. Kannee and McGeehan had previously been associated in Entron, Inc., a manufacturer of CATV equipment.

On or about April 15, 1964, while respondent was still waiting for action on its license application, Kannee telephoned the SBA and talked to a Mr. Wicker. He told Wicker that the proponents had informally agreed some time ago to buy debentures and stock of Cablevision, which had a CATV franchise from the City of Fredericksburg, and that they wished to advance $55,000 to keep construction crews at work. He asked whether SBA could expedite the license, or authorize release of $22,000 of the $155,000 on deposit so that "we might proceed with out first investment." The record does not show that Kannee told Wicker about his affiliation with Cablevision, but he must have conveyed the idea that there was some connection; for Wicker discussed the matter with one MacKinnon, and as a result (according to a memorandum in the SBA files) MacKinnon telephoned Kannee, on April 15, 1964, to inquire about any connections between proponents and Cablevision. MacKinnon reported to Wicker that there was "no overline" (it does not appear how the overline question came up) and "no 107.716(b) problem" except that Kannee would "serve as director to protect investment and may also be part time fiscal officer" at about $1500 per year; and that Kannee would set forth all particulars in a letter to Mr. Morris.

Pursuant to his talk with MacKinnon, Kannee wrote to John B. Morris, Director, Office of Investment Assistance, on April 16, 1964. He gave the substance of his talk with Wicker as set forth above, and also said:

"Mr. MacKinnon then telephoned to me and asked what, if any, connections existed between Proponents and Cablevision. I explained that none existed except that I am Secretary-Treasurer of Cablevision without salary, that the President of Cablevision, who has no connection with the proposed SBIC, is also employed without salary. This is not uncommon practice in the industry; the President and I have had more than a decade of experience in the industry, all of the investors look to us to 'oversee' — the fiscal end, as far as I am concerned, to see that the money is properly spent — and, since Cablevision has trained personnel residing in Fredericksburg, there is no justification, considering the size and type of business, for employing full-time officers at the salaries we would command.

* * * * * *

"Cablevision's directors authorized the issuance of $120,000 of 6% 10-year Debentures and $24,000 of $5 stock, deemed sufficient for the needs of this project. Cablevision has received $36,400 thus far, excluding pledges. It is anticipated that the full amount will be subscribed, including the $55,000 to come from proponents, one way or the other.

"My wife and her sister have jointly invested $3,000. None of the proponents of the SBIC owns stock or debentures, nor any members of their families (other than my wife's interest)."

The letter repeated the request that the license be expedited or that $22,000 be released from the bank pending issuance of the license.

On April 20, 1964, Morris noted in a memorandum to "Dick" (Kelley) that he had talked to Kannee on the telephone that day and had told him that the bank could not release the funds prior to licensing, that the license was still being processed, and that he (Morris) might have an answer late that week.

The license was issued May 14, 1964, and was transmitted to respondent without covering letter. Respondent started business with "statutory capital" of $301,000, consisting of $155,000 paid-in capital and paid-in surplus and $146,000 in SBA funds paid or committed pursuant to Section 302(a) of the Act.

On or about August 15, 1964, respondent purchased $54,000 of the debentures and 1,080 shares, at $5 per share, of the stock of Cablevision, for a total of $59,400; the investment having been delayed because, when respondent finally received its license, Cablevision had been trying to make a deal elsewhere. There had been no communication between respondent and the SBA with respect to respondent's connections with Cablevision since Kannee's letter of April 16, 1964, to SBA in response to SBA's request.

Meanwhile, on July 7, 1964, Kannee wrote SBA about a proposed loan of $55,000 (hereinafter the "Berwyn-Hartwick loan") to Berwyn House Joint Ventures, a partnership in which, he disclosed, Donald and Allen Wolpe each had a 25% interest. Kannee pointed out that each of the Wolpes owned 6% of respondent's stock, that both were directors and that Allen Wolpe was vice president of respondent. He stated that he and bookbinder, each a 44% stockholder of respondent, had approved the transaction. On the basis of Kannee's letter and "additional information" (not specified) received July 17, the SBA by R. E. Kelley, Deputy Administrator, approved the transaction "pursuant to Section 107.716(b) of the Regulations," by letter dated August 12, 1964.

In November of 1964 respondent was negotiating with Famor, Inc., a jewelry wholesaler seeking funds to expand its consignment sales operations. Respondent made a loan commitment in November, 1964. Kannee had known one of the two 50% stockholders of Famor since World War II and had represented him in tax matters; he had also represented Famor before the Federal Trade Commission. In February, 1965, Famor asked Kannee to go on its board of directors following a "little argument" among its two stockholders which Kannee had helped them settle;

Kannee accepted, because he thought it was politic to do so and would put him in a position to learn more about the company. He was elected a director February 3, 1965. Respondent made a 5-year loan of $60,000 to Famor on or about June 1, 1965. Neither Kannee nor anyone else connected with respondent has ever had any financial interest in Famor, or any interest of any kind other than Kannee's directorship as described above, except of course for interests arising out of respondent's loan to Famor. Following SBA's charge that the Famor loan violated Section 107.716(b) of the Regulations, Kannee resigned as a director after pointing out to SBA that it was desirable for respondent to have a man on Famor's board. His resignation was accepted February 11, 1966.

By April, 1965, Cablevision had run out of funds and urgently needed money to complete the installation of its community antenna system within the time fixed by its franchise agreement with the City of Fredericksburg. Respondent considered an additional investment of $34,800 necessary to protect its existing stake of $60,000. The Act and Regulations limited the amount of its investment in any one enterprise to 20% of its "statutory capital" of $301,000 (i.e., $60,200) unless prior written approval of any excess, or "overline," was given by the SBA. Respondent was aware of the limitation. Kannee telephoned SBA and talked to someone, but who it was he doesn't remember: he kept no memorandum of the call and did not confirm it by letter, and there is nothing in the SBA's files about it. He testified that he asked whether respondent could make an overline loan to back up an investment, and was told that it could do so if it was necessary to protect the original investment. Respondent's Vice President, Mr. Allen Wolpe, testified that he had questioned the propriety of the overline loan and that Kannee had then told him about the telephone call to SBA. The Examiner finds that Kannee did call someone at SBA about the matter; however, except as some showing of good faith — and of Mr. Kannee's tendency to be somewhat less than meticulous about what he considered merely formal details — the fact is not of controlling importance. The regulation re-

quires prior written approval of overline loans. There is no proof of the real or apparent authority of the person Kannee talked to, either to approve the transaction or to waive the requirement of written approval;[5] besides, the conversation as described by Kannee was such that it is questionable whether Kannee obtained anything more than the opinion of an SBA employee that approval of an overline might be given upon proper application where a need to protect an existing investment was shown.

Respondent proceeded to lend Cablevision an additional $34,800 on April 3, 1965 against its note due April 3, 1970, with interest payable quarterly at the rate of 10%. This brought the total investment in securities of Cablevision up to $94,800, which exceeded the amount permitted, without prior written approval of the SBA, by $34,600.

June 25, 1965, the SBA by J. T. Phelan, Acting Director, Office of Eastern Area SBIC operations, wrote respondent to state that it had completed an examination of respondent's operations as of April 30, 1965, and that certain "irregularities" had been noted. There followed 6 items, roughly, it would seem, in the inverse order of their importance; the first 4 consisted of a misclassification of a loan as a "305" instead of a "304" loan; establishment of a safe deposit box with only one signatory, in violation of SBA regulations; failure to obtain "Size Status Declarations" from borrowers, also in violation of SBA regulations; and failure to keep all documents available at licensee's office, which was deemed not to be sound business procedure. The last two items, and the balance of the letter, were as follows:

> 5. Each of the three current financings showed a significant degree of affiliation yet only one of these affiliated financings had been submitted to this Office for approval. Violation of Section 107.716 (Conflicts of Interest) exists with respect to your investments in Cablevision of Fredericksburg, Inc. and Famor,

[5] The Act requires "approval"; only the regulation requires "prior written approval."

Inc.[6] It is requested that appropriate steps be taken to eliminate these affiliations or that full explanation of the circumstances surrounding these affiliations be submitted to this Office for our consideration.

6. The investment in Cablevision of Fredericksburg, Inc., in the aggregate amount of $94,200 represents an overline of 31 percent or approximately $29,200 without the prior written consent of this Agency. This is in violation of Section 107.708(a) of the Regulations, which states in part that without prior approval of SBA, such investments "shall not exceed twenty percent of the combined paid-in capital and paid-in surplus of any Licensee." You are requested, therefore, to reduce this overline situation and to notify this Office of your steps in this direction.

Other than the above, the examination did not reveal further violations of the Act or Regulations. You understand, of course, that should subsequent findings reveal further violations this report may not be considered as a waiver thereof by SBA.

We appreciate your cooperation.

Very truly yours,

Respondent replied June 30, 1965, by its Vice President, Allen Wolpe. Mr. Wolpe explained how the first 4 items had been or were being taken care of, and said as to the last two items:

5. As to Cablevision of Fredericksburg, Inc.:

Concept of having an officer and director of this SBIC serve as an officer (without salary) and

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[6] The Famor loan was not consummated until about June 1, 1965, so could not have been discovered in an examination as of April 30, 1965, as stated in the letter. According to the uncontroverted testimony of Kannee the Famor "affiliation" was brought to SBA's attention by him when SBA first questioned the Cablevision affiliation; apparently the subject had been discussed orally before the letter of June 25, 1965 was written.

director (without compensation) of portfolio company was and is to safeguard application of all funds, particularly during construction period.

As to Famor, Inc.

Mr. Kannee has long been attorney for this Company and was elected a director early this year. The loan was made on the basis of his knowledge of the Company and of the financial status of the stockholder-endorsers of the Company's note. Here, again, Mr. Kannee can resign as director (no compensation) but it is desirable for our SBIC to have a constant view of what is transpiring with respect to the business and financial status of the portfolio company.

6. The original *investment* (in debentures at 6% and stock) was under the 20% limit. Funds were being applied to construction and, subsequent to the investment, it became necessary for the portfolio company to extend construction to comply with the technical terms of its franchise. Our understanding of the regulations was that an SBIC may make a *loan*, above the 20% limit, to protect its investment, and this was done, at 10% per annum, a rate fixed to expedite repayment, likely next year.

   If this action is in conflict with the regulations, please advise.

We appreciate your courtesy in calling our attention to the irregularities and assure you that it is our desire to cooperate.

Very truly yours,

Mr. Phelan acknowledged Mr. Wolpe's letter on July 16, 1965, and said:

We are pleased to note the corrective action you have undertaken with respect to certain irregularities noted in our report.

However, your explanation of the affiliated status of Henry M. Kannee with Cablevision of Fredericksburg, Inc. is deemed unacceptable by this Office. Information available to us indicates that Mr. Kannee's wife and sister-in-law were substantial and significant stockholders in Cablevision of Fredericksburg, Inc., prior to the Licensee's loan to this company. Your letter of June 30th fails to take this into consideration in your response to our examination report. Unless you can resolve this matter to our satisfaction you will be required to remove this investment from your portfolio.

Similarly, despite your contention that additional investment was necessary in order to protect the Licensee's loan to Cablevision of Fredericksburg, Inc., this in no way excuses the investment from the restrictive requirements of obtaining approval of an overline investment from this Office in compliance with Section 107.708(a) of the Regulations. Any further consideration of this overline will necessarily be held in abeyance until the question of affiliation has been resolved.

Your prompt advice regarding these matters will be appreciated.

Thus respondent's explanation of everything except the Cablevision affiliation and overline was accepted at this time. It may be noted that Wolpe's letter had not referred to Kannee's 1964 communications with the SBA in which the Cablevision situation had been disclosed prior to the issuance of respondent's license.

Meanwhile, in May and June, 1965, respondent had made two short-term loans aggregating $15,000 to Technical Animations, Inc. (hereinafter "TAI"), a corporation of which Bookbinder had been a director since 1962, and in which he held a small (less than 1%) stock interest as well as $1,000 of its $212,500 outstanding debentures.

After receipt of Phelan's letter of July 16, 1965, Kannee had one or more conferences with Phelan, in which he ex-

plained the Cablevision and Famor situations and also disclosed the $15,000 loan to TAI and Bookbinder's directorship. He confirmed the information by letter of August 12, 1965. Apparently he was asked why respondent had asked permission to make the Berwyn-Hartwick loan but had neglected to do so as to Cablevision, Famor and TAI. Kannee explained that he was conscious of the law against self-dealing, if not the regulations, and the Berwyn-Hartwick loan clearly would help two of the stockholders and directors of respondent (the Wolpes, it will be recalled, each had a 25% interest in the Berwyn-Hartwick deal, and owned 6% of respondent's stock). But, said Kannee, he did not see, and still failed to see, the "slightest taint of self-serving as to Cablevision, Famor and Technical Animations." The letter was unduly argumentative, and presumably reflected the tone of Kannee's conference with Phelan; if so it may explain the position adopted by SBA thereafter as well as Kannee's evident frustration. Even the Famor transaction, which was clearly an insubstantial violation if at all and apparently was so considered by SBA at the time of Phelan's letter of July 16, now became one of the major issues.

The SBA did not reply to Kannee's letter, and nothing seems to have happened (except that the SBA refused to lend respondent any funds pursuant to Section 303 of the Act) until October, when Kannee was able to arrange a meeting with the Assistant Deputy Administrator for Investment, Mr. Leisy, along with Phelan and another. Kannee was told to write a letter stating the nature of each investment and the association with each of individuals in the SBIC, and to request retroactive approval. Kannee did so by letter of October 22, 1965, an eight-page document in which he repeated the Cablevision, TAI and Famor situations with further detail and argument. Retroactive approval or waiver was requested with respect to each. In closing, Kannee pointed out that respondent had been "incarcerated" since July — "literally told to remain inactive — which is more than enough punishment for technical non-compliance."

Months went by without any reply to Kannee's letter of October 22, 1965. In or about November the short-term loans to TAI were discharged. TAI used for the purpose cash which it received upon the exercise of stock options held by respondent; respondent had sold part of the stock (or assigned the options to purchase such stock) at a profit. As a result of the transaction respondent received 6000 shares of TAI stock plus the $15,000 in payment of its loan. On or about January 18, 1966, respondent participated with two other SBIC's in the purchase of 540,000 shares of stock of TAI for an aggregate purchase price of $450,000; such financing had been contemplated when respondent made its $15,000 short-term loans to TAI in May and June, 1965. Respondent's participation was 72,000 shares for an investment of $60,000. On the closing date, respondent and the two other SBIC's entered into an agreement with the President of TAI under which he agreed that at the next stockholder's meeting, to be held February 7, 1966, and at all such meetings thereafter as long as the SBIC's held the stock purchased that day, he would vote all his stock and use his best efforts to cause other stockholders to vote their stock, for 6 directors to be designated by the SBIC's, out of a board of 11 directors. Among the 6 directors designated by the SBIC's, and for whom their stock was voted, was George Bookbinder, who as noted above owned 44% of the stock of respondent. It had been agreed among the 3 SBIC's, as part of their participating purchase arrangement, that he would serve on the board, since he had been familiar with the business as a director since 1962.

On January 26, 1966 the Assistant Deputy Administrator for Investment finally replied to Kannee's letter and request of October 22, 1965. The letter recited the bare facts of the Cablevision and Famor financing and the short term loans to TAI, which by this time had been discharged. It described briefly the "affiliation" with each borrower, stated that the financing violated Section 107.716 or Section 107.708(a) of the Regulations, and concluded:

> If we understand you correctly, you plead in effect that the above activities were done without inten-

tionally violating the Regulation and through a misunderstanding on your part of the purposes of said Regulation. You further indicate that to eliminate the problems by divestiture is not practical and for SBA to require it is punitive.

Based on all the facts, we cannot grant retroactive approval but will give you a reasonable and necessary time to bring this situation within the regulatory provision.

Pending this interim period we, of course, could not grant any application for exemptions or consider any application for a loan.

We trust that this meets with your approval.

Some weeks later, Kannee conferred with Mr. Bender, the Acting Chief, Office of Eastern Area SBIC Operations. At the latter's request, Kannee wrote March 7, 1966 to "reduce our discussion to writing." After noting that the letter of January 26, 1966, had not stated what should be done, and that the Assistant Deputy Administrator had orally stated in conference prior to that letter that the only item of real concern was the Cablevision overline, Mr. Kannee's letter stated:

As to your request for information as to what has been done thus far and as to how the individual investments are faring, the time has been short but I can state the following:

(1) As to Cablevision, Mr. Leisy's concern about the "overline" became ESIC's concern.

I did suggest that the stockholders increase ESIC's capital by the amount of the overline, to which Mr. Levine countered that it would have to be three times as much although ESIC did not look for matching funds from SBA.

* * * However, it is felt that Cablevision should be able to obtain sufficient bank accommodation to repay ESIC — and save interest — as soon as FRB pressure eases. Also, the market for

CATV systems being good, there is a possibility of sale of the entire Cablevision system.

If time is of the essence, would it cure the situation if the stockholders of ESIC simply bought ESIC's Cablevision note for the $34,800?

(2) As to Famor, I resigned as director on Feb. 11th, the first meeting since the loan was made last June.

As to your request for information as to what Famor was able to accomplish with the loan of $60,000: The $60,000 bought additional credit, enabling Famor to greatly extend consignment credit to more stores. Famor's gross climbed half a million and it has transferred $30,000 from profit to capital thus further securing ESIC. * * *

If a technical correction is required, it would be a simple matter to ask Famor to repay PROVIDED a new loan in the same amount is made. But the real job to be done, in line with the objective of Congress, is to do for Famor what was done for TAI (next item).

May we now get a "green light" on Famor?

(3) As to TAI, the $15,000 short-term loan has been repaid.

ESIC had been working since 1964 to finance TAI. It needed at least $400,000, to which ESIC could contribute no more than $60,000. And what ESIC saw — a new and fine contribution to the printing and photographic arts — merited that financing.

But, while negotiations were proceeding, payrolls had to be met, otherwise everything would be in jeopardy, including an SBA loan. And so the $25,000 short-term loan was raised, which included the $15,000 by ESIC after I called SBA, explained the situation, and was informed that the loan could be made.

> The major plan of financing has been consummated in the amount of $500,000 contributed by four SBIC's, ESIC included. As part of the plan of financing, TAI's entire Board of 11 resigned and a new Board elected which includes six members designated by the SBICs.
>
> TAI now has contracts with Eastman Kodak, American Book Co. and others. * * *
>
> May we now get a "green light" on TAI?

The letter also asked for "SBA guidance" on two matters, one of which was Ridgecrest Condominium Corporation. Respondent had loaned $38,000 to Ridgecrest. It proposed (a) a further loan of $22,000 (its original commitment had been $50,000); (b) an advance of $20,675 to collateralize a contractor's performance bond; and (c) additional loans of not to exceed $19,745, should the need materialize. All these additional loans were to enable Ridgecrest to proceed with construction in advance of receipt of FHA funds, and were said to be necessary to protect the existing loan of $38,000 which might be lost if the project collapsed.

April 14, 1966, respondent received a reply over the signature of J. T. Phelan, Director, Office of Eastern Area SBIC operations. The letter refused the requested "green light"; stated that the "short-term financing of TAI" was the only matter satisfactorily resolved by respondent's letter; and proceeded for the first time to spell out a requirement that the Famor and Cablevision financings, as well as respondent's participation in the new joint financing (with other SBIC's) of TAI, be "corrected" by "complete divestiture":

> Our position in regard to your financings of TAI, Famor, and Cablevision, as it relates to conflicts of interest and the Cablevision overline necessarily remains unchanged since no corrective action has been taken.
>
> Your resignation as a director of Famor does not eliminate the affiliated nature of this transaction.

Affiliations govern which exist 6 months prior to the time of the financing or occur within 6 months after its consummation.

We are cognizant of the difficulties you may encounter in resolving the above matters and, as stated in our previous letter, will give you a reasonable and necessary time to correct them and by correction, we mean complete divestiture of these financings by the Licensee.

We will continue to work with you in the resolution of these matters.

As to Ridgecrest, the letter stated:

In connection with Ridgecrest you state that Licensee is committed to lend $50,000 of which $38,000 has already been disbursed. The Licensee's board has also authorized the use of $20,675 in certificates of deposits as a performance bond for a period of less than 6 months and a loan of $22,000 in addition to the $38,000 already disbursed. Total investment in Ridgecrest, including the performance bond, will then be $80,675, which exceeds Licensee's maximum loan limitation by $20,675. SBA will interpose no objection to the aforesaid overline in view of the circumstances involved since the overline created by the performance bond was necessary to protect the Licensee's original investment and will be eliminated in less than six months.

The record does not show the basis for SBA's conclusion that the advance of $20,675 to Ridgecrest for use as collateral for a contractor's performance bond would be eliminated in "less than six months"; respondent's letter of March 7, 1966 gave no assurance thereof, but in fact contemplates an overline advance of $19,745 in addition to the $20,675 for the contractor's bond.

May 19, 1966, SBA wrote with reference to Cablevision, Famor and TAI, and asked to be advised of action by respondent "in response to our earlier requests." The

letter stated: "While we are aware of the problems you may be encountering in divesting yourself of these investments, we must insist upon periodic reports of the progress made by the Licensee in resolving these matters."

Mr. Kannee replied May 31, 1966. He pointed out the difficulty of liquidating investments such as those in question, but reported that one-third of the $60,000 investment in TAI had been recovered and that it was hoped the balance would be recovered in two or three months. Negotiations with other SBIC's to "more adequately" finance Famor were reported, as was the possibility of prepayment of Cablevision's loans in the near future; the tight money market was deterring potential purchasers of Cablevision's system. He repeated that respondent's stockholders would take up the Cablevision overline if that would cure the Cablevision situation, but assumed from Phelan's letter of April 14 that that offer was declined. He noted that he had planned to report progress as it occurred, but would provide periodic reports if the SBA would specify when.

The SBA, by Phelan, replied June 9, 1966, repeating its appreciation of the problems of divesting respondent of the loans and stating that the SBA "will work with you in the resolution of these matters. We would, however, appreciate quaterly reports of the Licensee's efforts to correct the deficiencies noted in our letter of January 26, 1966."

On July 21, 1966, Kannee met with Bender and Friess, who had been assigned to the Middle Atlantic Division as account executive in April, 1966. At the July 21 conference, it was suggested that respondent's stockholders put in another $145,000 which would bring respondent's paid-in capital up to $300,000; with the purchase of debentures by the SBA pursuant to Section 302(a) of the Act, this would bring respondent's statutory capital up to $600,000 and automatically take care of the overline problems. Friess and Bender said they didn't have authority to approve anything, and told Kannee that any offer would have to be in writing. Kannee discussed with them what he should say in the letter; the second paragraph was apparently a result of that discussion, but it is not clear

what it was intended to mean, at least with respect to the existing "affiliations." Under date of July 23, 1966, respondent wrote to Bender as follows:

> Confirming discussion had with you and Mr. Friess yesterday, this Licensee proposes to increase its capitalization to $300,000. Such capitalization, including SBA matching funds for which it would be eligible, would provide for the overline in its present situation.
>
> This Licensee will, upon approval of SBA, promptly conform with the SBA Rules and Regulations codified as of Jan. 1, 1966.

The SBA never replied to this letter.

About two weeks later, another crisis arose in connection with Ridgecrest. FHA had delayed payment of invoices, contractors were insisting on payment, and $10,000 was necessary to prevent work from coming to a halt. Kannee tried unsuccessfully to reach Bender or Friess by telephone. Respondent's directors decided to advance the $10,000 upon an agreement — reflected in the corporate minutes — that the directors of the respondent corporation would personally take over the temporary loan if SBA did not approve. Kannee reported the transaction by letter of August 9, 1966, which instead of producing SBA approval became its exhibit in support of Count V of the order to show cause. The directors took up the loan prior to issuance of the order to show cause, although it does not appear that SBA knew it at the time the order was served.

Following the meeting on July 21, 1966, Kannee had made arrangements for the $145,000 additional capital; however, several weeks went by without any reply to the letter of July 23rd. When he telephoned Friess to find out what was going on, Kannee was told that there had been a "change," and that he would have to see Mr. Greenberg, who had become Associate Administrator for Investment in July. Kannee arranged for a meeting with Greenberg, which was held August 19, 1966. Thereafter the letter dated August 29, 1966, referred to in the order to show cause, was sent over Greenberg's signature. The letter

does not, as alleged in the order, request corrective action to be taken within 15 days of receipt thereof; it does, however, request respondent "to furnish this office with a plan within 15 days of the receipt of this letter, whereby the Licensee will take the following corrective actions." The actions for which a *plan* is requested are:

1. Liquidation of investments in Cablevision, Famor and TAI.
2. Reduction of investment in Ridegcrest to not more than the 20% limitation imposed by Section 107.708 (a) of the Regulations.
3. Liquidation of a loan to Keller Holding Corporation, alleged to be an apparent violation of a regulation relating to loans to "passive" businesses.
4. Liquidation of a $6000 short-term loan to an unidentified concern, which had been mentioned in Kannee's letter of August 9, 1966.
5. Recovery of $1,000 paid to Licensee's officers in excess of salary limitations set forth in Licensee's "Proposal."

Kannee replied by letter dated September 6, 1966. The letter, which runs to nine pages, is rambling and occasionally intemperate, though not without evident provocation. It appears that Kannee had been given short shrift at the meeting of August 19. The letter reviews, in some detail, various phases of the matters in issue. Among numerous irrelevancies it discloses the plan already being followed as a result of earlier discussions, and sets forth proposals for SBA approval.

As to Cablevision, the letter states that the only way to "divest" is through sale of the system; that an offer has been made to the most likely buyer; that selling is not easy under present market conditions; that respondent would undoubtedly recover all its cash but may have to take the buyer's notes. Kannee asks whether that would be considered.

As to Famor, he points out that the loan could have been taken in any one of three corporations; that he was only a director of Famor; that the loan could, as he had told the staff, be transferred to one of the "unaffiliated" corporations. However, the staff had suggested the proposal (which respondent had thereafter made in writing) to increase respondent's capital to $300,000, which was apparently understood to be in lieu of divestiture.

As to TAI: $36,500 of participations in the $60,000 investment had been sold off. Merrill, Lynch had been approached to find a private investor, but must investigate and this takes time. "That is where the TAI situation stands, as your staff knows."

As to Ridgecrest: the existing overline of $20,675 was authorized by the SBA. The $10,000 emergency loan was to be picked up by the directors if the SBA objected, so it couldn't be called a violation. The letter goes on to make an urgent request for the approval of an additional $19,745 overline which had been asked for in Kannee's letter of March 7, 1966 but ignored. It is noted that the proposed increase to $300,000 paid-in capital would automatically liquidate this overline.

The remaining items — numbered 3, 4 and 5 above — were also discussed; they need not be gone into here since they are not mentioned in the order to show cause, notwithstanding SBA's rejection of the entire letter.

By letter of September 13, 1966, Greenberg denied the "request for approval of the acquisition of securities of Ridgecrest" in excess of the limit set by the Act; and otherwise stated only that Kannee's letter "does not meet the specifications of the plan which my letter of August 29, 1966, requested."

On September 21, 1966, Kannee wrote to say that the letter of August 29th had not set forth any specifications of any plan; that respondent believed its letter of September 6th was responsive; and that if Greenberg knew of "a better plan than we have been following, please let us know." The same day, the order to show cause was issued.

Discussion and Conclusions

Counsel for SBA contends that respondent's dealings with the Agency after the various transactions had taken place and were brought to the attention of respondent have no bearing upon the issues. The trouble with that contention is that the order to show cause itself alleges the letter of August 29, 1966 as notification and a request for corrective action, and further alleges that respondent failed to comply "within the fifteen days of receipt of said letter and has still failed to do so"; allegations which are denied or avoided in respondent's answer. Thus the pleadings put in issue everything that occurred up to the date of service of the order to show cause, particularly insofar as it concerned "corrective action" requested by SBA or taken or offered to be taken by respondent.

The transactions alleged in the respective counts of the order to show cause to constitute violations of the Act or Regulations will be discussed *seriatim.*

1. *The Cablevision Affiliation:* Respondent informed SBA that it proposed financing of Cablevision, and asked that the issuance of its license be expedited for that particular purpose. Contemporaneously, at SBA's request, it informed SBA of connections, existing or contemplated, between respondent and Cablevision: that Kannee was Secretary-Treasurer of Cablevision; that Kannee would continue to serve as such and as a director of Cablevision to protect the investment; and that Kannee's wife and her sister had jointly invested $3000, which was perceptibly more than 10% of the $24,000 of $5 stock stated to have been authorized and nearly 10% of the total of $36,400 stated to have been received from stock plus debentures issued. With knowledge that respondent proposed to proceed with the financing immediately upon receipt of the license, and that the information then in its files concerning the Cablevision affiliation was given for no other reason, SBA issued the license without reservation or comment. Under the circumstances, SBA's action must be construed as approval of the Cablevision affiliation; and respondent was justified in relying upon SBA's action as

constituting such approval and a waiver of its requirement (not contained in the statute) that approval be received in writing. To hold otherwise would require a finding that the action of SBA's representative in telephoning respondent and requesting a letter setting forth the facts, and the action of respondent in sending the letter as suggested, were completely meaningless gestures and should have been recognized as such by respondent. Respondent was obliged to conform with the SBA's regulations, but the agency also had an obligation to inform respondent if it was not satisfied with respondent's disclosed intention — particularly since respondent was embarking on its first transaction and might reasonably have expected a word of guidance if there were any doubt about the propriety of its announced purpose. During the 4 months from the date of the request until the consummation of the Cablevision financing, respondent had no word from SBA, as far as the record shows, except a telephone call to the effect that funds on deposit (representing the minimum paid-in capital and surplus required of a licensee) could not be released prior to licensing, that the license was being processed, and that word concerning the license was imminent; followed by issuance of the license itself. Respondent might reasonably assume that SBA approved the affiliation; and unless we assume utter disregard by SBA of respondent's request and disclosure, the plain inference is that SBA did in fact approve when it transmitted respondent's license without comment.

There is a quibble as to whether it was disclosed that Kannee was a director before the loan was closed, or only that he would serve as a director thereafter. Kannee did not mention the directorship, past or prospective, in his confirming letter, but the telephone memorandum in SBA's files establishes that he notified SBA at least of respondent's intention that he be on Cablevision's board. Kannee testified (in answer to a leading question, it is true) that he advised SBA that he "intended to *continue* to serve as a director to protect the investment," and the Examiner finds that he did so; such disclosure would have been normal under the circumstances shown by the memorandum

and letter, although it was hardly of controlling importance. There is also a quibble as to whether it was disclosed that the "investment" of Mrs. Kannee and her sister was in stock (and therefore represented an equity interest) rather than in debentures of Cablevision; while respondent raises a question as to whether a sister-in-law should have been considered a "close relative" under the regulation as it read at the time. It is not necessary to decide the last.[7] If the disclosure as to the nature of the investment was ambiguous, it was nevertheless sufficient to put SBA on notice; SBA could not assume that it referred to debentures, and if SBA felt that the point was determinative it should have asked for clarification. Apparently SBA was satisfied with respondent's disclosure and found the proposed investment unobjectionable; and the pertinent documents were merely filed and forgotten.

2. *The Famor Loan:* Following Wolpe's explanation that Kannee had become a director of Famor early in 1965 — the loan having been made June 1, 1965 — and that it was desirable for respondent to have a constant view of Famor's business and financial operations, SBA dropped this matter in the first instance, as well it might; it was of trivial significance, and did not in fact constitute a violation of the provisions of the "conflict of interest" regulation. Apparently as a result of an unfortunate interaction of personalities which began to develop immediately thereafter, the Famor matter was reconsidered, thought suspect and again asserted to be a violation.

Section 107.716 of the Regulations, at the time of the Famor loan, was captioned "Conflicts of Interest"; prior to February 15, 1965, when its form but very little of its substance was substantially changed, it was captioned "Self-

[7] The question is not entirely free from doubt. It may be noted that the regulations under the Securities Exchange Act of 1934, in defining the term "associate," refer to "any relative or spouse of such person, or any relative of such spouse" — suggesting that an in-law isn't a relative at all. The SBA regulation now in effect specifies the particular in-laws covered by the term "close relative," but there was no definition of the term in the regulation effective prior to February 15, 1965.

dealing Limitation." It serves to implement Section 312 of the Act, added in February, 1964, which requires that SBA adopt regulations for the purpose of controlling conflicts of interest which may be detrimental to small business concerns, SBIC's, the shareholders of either, or the purposes of the Act. Neither the law nor regulation forbids every conflict of interest; their purpose is the control of such conflicts. To achieve control, the regulation requires disclosure and prior approval of financing where any of certain relationships exists.

The gist of the revised regulation, as far as pertinent here, is that an SBIC may not, without prior SBA approval, provide financing to a concern of which any one of its officers, directors, or 10% stockholders is an officer or director or has a 10% equity interest. Paragraph (h) thereof provides, however:

> "(h) *Protection of investment.* Nothing herein contained is intended to preclude a Licensee from permitting an officer, employee, or representative from serving[8] as an officer, director, or in any other capacity in the management of a small business concern for the purpose of protecting its investment in or loan to such concern."

Paragraph (h) recognizes the desirability, from the standpoint of a lender or investor, of having a representative so placed in the management of a concern as to be able to observe what is going on and look out for the investor's interests, to the extent that he can properly do so; and thus makes an exception to the requirement of prior approval where that is the interest to be served, from the standpoint of the incumbent. Of course it is legally impossible for a director to have no other function. It is the duty of directors, as a board, to manage the affairs of a corporation. A director is a fiduciary and agent of the corporation, and may not derive any advantage hostile to its interests

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[8] "From serving" should obviously be read "to serve."

through his position. Subject to such responsibility and to full disclosure of his interests, however, he may with propriety represent, in the deliberations of the board of directors, the interests of particular stockholders or of creditors, such as respondent; and that is implicit in paragraph (h) of Section 107.716.

Counsel for the SBA argues that paragraph (h) is not, as respondent contends and as Kannee evidently assumed, an exception to the requirement of prior approval regardless of any other interest or pre-existing affiliation. Thus far the Examiner agrees with SBA counsel, although the regulation is not so clear as to indicate that Kannee's interpretation was not adopted in good faith. It seems to be SBA counsel's position, however, that in a case where an SBIC representative becomes a director of the borrower at any time during the period of 6 months before and after the financing, regardless of purpose, prior SBA approval of the financing would be required. This would make paragraph (h) quite meaningless. The regulation is, however, something less than clear. The six-month provision does not (as counsel suggests and as was perhaps intended) forbid unapproved financing if the specified affiliation exists within 6 months before (or after) the financing; it merely says that if the position is held during such before-or-after period it shall be deemed to have been held on the date of financing.[9] The provision substitutes a presumption for proof that an interest existed on the date of financing, and has no application here, where Kannee was actually a director of Famor on the date of financing and doesn't have to be "deemed" to have been such.

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[9] The regulation in effect prior to February 15, 1965, was quite different on this point; it clearly provided that approval was necessary if the financing was consummated within 6 months after *termination* of the affiliation. The revised regulation makes the test actual or constructive holding of the position on the date of financing, which may or may not produce the same result. It would make it impossible, under SBA counsel's interpretation, to have a representative go on the borrower's board within 6 months *after* the financing, since it requires *prior* approval not of the subsequent incumbency, but of the financing which has already occurred.

A reasonable construction of the regulation is contrary to the contentions of both parties. Paragraph (h) does not permit a complete avoidance of the requirement of prior approval, regardless of the nature of the affiliation existing at the time of the financing; but neither is it merely a statement of what SBA will approve if requested to do so. Where the affiliation consists of the occupancy of a position in the borrower's management (as here) the necessity for prior approval depends on whether or not the interest of the incumbent when he assumed the position related solely — or substantially so — to the SBIC's investment.

In the Famor situation, there can be no doubt. Neither Kannee nor anyone else connected with respondent had any interest in Famor at any time prior to the financing except for the bare directorship assumed by Kannee after respondent's loan commitment to Famor had been made.

The regulation's treatment of a common directorship as a possible conflict of interest has a sound basis in theory. "The relation of directors to corporation is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation * * *. Especially is this true where a common director is dominating in influence and character." *Geddes v. Anaconda Mining Co.*, 254 U.S. 590, 599. But where a borrower is a small, closely-held corporation, where *all* the corporation's stock is held by non-common directors and none by the single common director, it cannot seriously be contended that the common director has any real interest contrary to that of the lender — particularly where he is a 44% stockholder of the lender. The adverse interest claim could theoretically be advanced by the stockholders of the borrower, but even then it would be difficult to imagine any substance to the claim where there was complete disclosure and all the stock was owned or controlled by other directors comprising a majority of the board. In short, there was, from Kannee's point of view, no substantial personal reason for him to become or act as a director of Famor except to benefit ESIC, where his entire personal interest lay.

Counsel for SBA says Kannee became a director of Famor for the purpose of becoming an arbitrator on its board of directors (that, roughly, was why the stockholders asked him to go on the board) and *to be in a position to learn more about Famor.* But why did Kannee want to learn more about Famor? Obviously because he was and had for some months been negotiating a loan on behalf of respondent. Certainly "the purpose of protecting its investment in or loan to such concern" is broad enough to cover the business of finding out more about a company before as well as after consummating a loan. Counsel's contention that a loan cannot be "protected" before it is consummated is unrealistically literal. "Protect" as used in the regulation is obviously not used in the literal sense of shielding physically, or even with the meaning which it "ordinarily" has in "promises of men of business" of assuming the obligation to see that the debt of another is paid at maturity. *Wabash, St. L. & Pac. Ry. Co. v. Ham,* 114 U.S. 587, 596. Rather it is used figuratively to mean looking out for the lender's interests and keeping it informed of the state of the borrower's financial affairs. That purpose is furthered by having a representative in position at or prior to the consummation of the financing; it would be even more useful to have an insider's view of a company before than after a loan is made, where that is possible.

It is concluded that Kannee was, at all times when he was a director of Famor, a director for the purpose of protecting respondent's investment in or loan to Famor, within the meaning of paragraph (h) of Section 107.716 of the Regulations; that he had no personal interest except in his capacity as an officer, director and stockholder of respondent; and that by reason of the circumstances under which he became and served as a director of Famor, no prior approval by SBA of the Famor loan was required under the said Section 107.716 of the Regulations.

3. *The TAI Financing:* The essential difference between the TAI and Famor situations is that when the first TAI loan was made in May, 1965, Bookbinder, a 44% stockholder of the SBIC, had been a director of TAI since 1962.

Thus it could not be said that he was at all times a director for no other reason than to protect respondent's investment. He also had a financial interest in TAI through his ownership of less than 1% of its stock and $1000 worth of its debentures; although under the regulation such a financial interest, being less than a 10% equity interest in TAI, does not require approval. In any event such pre-existing personal interest as he had in TAI was trifling compared with his investment of over $68,000 (44% of its capital) in respondent. This contrasted with the circumstances of the Berwyn-Hartwick loan, where two directors and stockholders (one of them also was a vice president) of the SBIC owned, in the aggregate, a 50% interest in the borrower. Berwyn-Hartwick was approved by SBA notwithstanding this substantial conflicting interest, where the majority stockholders of the SBIC had no interest in the borrower and approved. The TAI "affiliation" would undoubtedly have been approved by SBA as a matter of course upon a prior application, since there was no substantial conflict of interest at all; a fact which SBA seems never to have considered when insisting that the financing be "divested."

It will be recalled that the first short-term loans to TAI aggregating $15,000 were repaid. Thereafter ESIC participated with two other SBIC's in equity financing of TAI. As an incident to this financing, the concern's principal stockholder agreed to cause six members of the eleven-man board of directors, to be elected at the next stockholders' meeting, to be designees of the SBIC's. Pursuant to the agreement, Bookbinder was elected to the board, as one of the six directors designated by all the SBIC's acting jointly. This documented procedure was precisely as contemplated by paragraph (h) of Section 107.716 of the regulations; and since, under that paragraph, *nothing* in the regulation is intended to preclude a licensee from permitting its representative from serving as a director for such purpose, it is clear that Bookbinder could not have been required to give up this directorship, and in fact he did not.

SBA considered, however, that the fact of Bookbinder's prior directorship required prior approval of the financing,

and that because of failure to obtain such prior approval respondent had violated the regulation. In that conclusion SBA was undoubtedly right, no matter how insubstantial the violation may have been.

It is found not to have been a willful violation, however, because respondent believed, in good faith though erroneously, that the exception contained in paragraph (h) of Section 107.716 applied when there was in fact no substantial conflict of interest and the purpose of paragraph (h) was being served, notwithstanding prior existence of the directorship. The Examiner is impressed, in this connection, by the fact that in the Berwyn-Hartwick matter, where there was in fact a substantial conflict of interest, respondent requested and received approval in accordance with the regulation.[10]

Neither was it a "repeated" violation. SBA alleges two earlier violations of the same regulation, but neither of the relevant transactions is found to have constituted a violation. Even if they were, however, none of them was subsequent to SBA's calling attention to, and stating its position with respect to, any of them.[11] This transaction and the Famor transaction had already been undertaken and were voluntarily disclosed to SBA by respondent when SBA re-discovered in its files the facts concerning the Cablevision affiliation and raised a question about that matter.

Nevertheless SBA, by its administrative personnel, refused to approve the TAI financing retroactively or to

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[10] Although SBA counsel asserts that respondent has "willfully and repeatedly" violated the Act and Regulations, the order to show cause does not so allege. On the contrary, the letter of August 29, 1966, referred to in the order as notice of violation thereof, is relied upon by SBA counsel as compliance with the notice provisions of Section 9(b) of the Administrative Procedure Act (5 U.S.C. 558) which apply *except in cases of willfulness.*

[11] The purpose of the notice provisions of Section 9(b) of the A.P.A. is to give the licensee "another chance." See the Attorney General's Manual on the Administrative Procedure Act (1947), pp. 90-91.

waive the application of its regulation, after suggesting that respondent request it to do so. Instead, it in effect demanded that the baby be thrown out with the bath by insisting that respondent "divest" itself of the financing. Such a "remedy" is not reasonable in relation to the violation. The financing itself does not violate the Act or Regulations, since there is in fact no detrimental conflict of interest. The violation was in entering into the financing without the prior approval required by the existence of a common directorship, a situation which does not of itself make the *financing* illegal. Here, divestiture is not necessary to expunge a continuing violation, for there is no continuing violation; SBA's only conern, under the circumstances, is to insure that there be no repetition of the practice of financing a concern without prior approval where there exists one of the potentially detrimental relationships described in Section 107.716 of the Regulations. For this purpose divestiture is unnecessarily drastic, and tends to defeat, rather than further, the purposes of the Act. Cf. *Gilbertville Trucking Co. v. U. S.*, 371 U.S. 115, at p. 130. The securities — notes, debentures or stock of small business concerns — held by SBIC's are not marketable securities; if they were there would be no need for SBIC's. To "divest" its holdings of TAI stock, respondent would have to find not an ordinary buyer or investor, but someone willing to do what SBIC's were created to accomplish: provide venture capital to small concerns whose principal asset is a putative growth potential. As SBA says in its pamphlet, "Starting a Small Business Investment Company," there were, prior to passage of the Small Business Investment Act of 1958, "few places a small company could turn for money, once it had exhausted its credit from relatives of the owners, from friends, banks and the Small Business Administration." Nothing would be gained by requiring respondent to beat the bushes until it found a venturous investor willing to take the TAI stock off its hands.[12] There is no real conflict of interest, notwith-

[12] SBA explicitly recognized the difficulty and offered a "reasonable and necessary time" to divest; and it indicated the length of time foreseeably necessary by asking for *quarterly* reports of respondent's

standing a technical violation of a regulation whose only purpose is to discover and achieve control of such conflicts. The only violation of the regulations was failure to secure prior approval of an investment in a company in which a common directorship existed prior to the investment and did not come into being, in the first instance, for the purpose recognized by paragraph (h) of the regulation. If there were in fact a conflict of interest which might be detrimental to anyone it might conceivably be necessary, to achieve compliance with the purposes of the Act, to require divestment; but that is not the case here.

As stated above, the violation occurred not just from the financing, but from the financing plus the fact of Bookbinder's position as a director. It would be just as logical, and superficially less burdensome, to require Bookbinder's resignation instead of "divestiture"; but he undeniably serves to protect respondent's investment and to require his resignation would clearly be contrary to the purpose of the regulations. There is no existing interest within the contemplation of the regulation which need be eliminated.

It has been found that the violation was not willful, and it may safely be assumed that respondent's experience in this proceeding will make it more responsive to regulation in the future. If respondent persists in violation of this or other regulations, suspension or revocation of its license pursuant to Section 309(a)(4) may be the necessary and appropriate remedy. At present, to require divestiture of the financing as a remedy is inappropriate and unwarranted.

4. *The Cablevision Overline*: The loan to Cablevision of $34,800 on April 3, 1965, violated Section 306 of the Act and Section 107.708(a) of the Regulations in that it was made without the approval of the SBA and brought the aggregate amount of funds of respondent loaned to, or invested in equity securities of, Cablevision to an amount which exceeded 20% of the combined paid-in capital and

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efforts. SBA repeatedly asserted that it would work with respondent "in the resolution of these matters," but there is no evidence that it was able to accomplish anything.

paid-in surplus of respondent as defined for the purpose in the Act and Regulations. The record does not support respondent's contention that SBA approved the transaction by telephone or waived its requirement of written approval.

However, prior to SBA's letter of August 29, 1966, alleged in the order to show cause as notification to respondent of its failure to operate within the purview of the Act and Regulations, respondent had proposed, upon SBA's approval, to eliminate the overline in either of two ways: by the assumption thereof by its directors, or by an appropriate increase in its capital, either of which respondent was ready, willing and able to accomplish. SBA failed to approve or permit the elimination of the overline by either of these methods, however, and insisted that respondent "divest" itself of the entire Cablevision financing. Such complete "divestiture" was not a proper or reasonable remedy under the circumstances. The original loan was within the limitations of Section 107.703(a) of the Regulations and Section 306 of the Act and (for reasons set forth above in connection with Count I) was not otherwise in violation of the Regulations or Act. The only transaction which violated the limiting provisions was the $34,800 loan. Cf. *Corsicana Nat'l Bank v. Johnson,* 251 U.S. 68, 87 (1919).

It appears that respondent has, since the proceeding was commenced, eliminated the overline by sale of the $34,800 note.

Counsel for the SBA cites numerous Federal Trade Commission cases, but none involving a licensing agency, for the proposition that a cease and desist order is proper even though the acts complained of have been discontinued, or were discontinued before the proceeding commenced. The purpose of a cease and desist order of the Federal Trade Commission has little in common with the purpose of such an order of SBA, as appears from a comparison of Section 5 of the Federal Trade Commission Act (15 U.S.C. 45) and Section 309 of the Act. A licensor such as SBA may issue a cease and desist order when necessary to stop a current violation of law or its regulations; there is no

occasion for it to issue an order to prevent possible future actions specifically forbidden by its regulations. Its remedy for repeated or willful violations is suspension or revocation of the license, and a cease and desist order is not a necessary prerequisite to such action. The Federal Trade Commission has a different problem; it is charged with preventing practices which it finds to violate a general statute addressed to unfair competition, and its efforts would be thwarted if a respondent could avoid a cease and desist order specifying the practice to be enjoined, simply be discontinuing the practice until after the Trade Commission's proceeding was completed.

It may be noted that the order to show cause here seeks an order requiring respondent to "cease and desist from *continuing* to violate the Act and Regulations." This assumes a continuing violation, which does not exist with respect to the Cablevision overline.

It is found, as stated above, that respondent violated the Act and Regulations in making the Cablevision overline. It is further found, however, that such overline was granted in the belief that it was necessary to protect respondent's already substantial investment in Cablevision. Respondent's action was somewhat comparable to that of the defendant in *Felton v. United States*, 96 U.S. 699, summarized in *United States v. Murdock*, 290 U.S. 389, 395, as follows:

> . . . In *Felton v. United States, supra*, the court considered a statute which required distillers to maintain certain apparatus to prevent the abstraction of spirits during the process of distillation and which declared that if any distiller should "knowingly and wilfully" omit, neglect, or refuse to do anything required by law in conducting his business he should be liable to a penalty. It appeared that in defendant's plant defective appliances caused an overflow and wastage of low wines, and to save these it became necessary, in disregard of the method prescribed by the Act, to catch the spirits and pour them into vats. This was done despite instructions to the contrary by the government officers who were consulted as to what procedure

should be followed. It was admitted that the action was innocent in purpose, saved loss of the product to the owner and taxes to the United States. In an action for the statutory penalty the conduct of the distiller was held not to be willful within the meaning of the law.

The present regulation does not require that conduct be willful to constitute a violation, as did the penal statute in *Felton v. United States;* it is concluded, however, that respondent's violation of Section 306 of the Act and Section 107.708 of the Regulations was not willful within the meaning of Section 309(a) of the Act. Accordingly it is not in order to suspend respondent's license because of such violation.

5. *The Ridgecrest Overline*: The only unapproved overline financing in connection with Ridgecrest was a temporary advance of $10,000 made upon the prior undertaking of respondent's directors and stockholders to take up the loan personally if SBA did not approve; and when SBA failed to approve (notwithstanding that respondent's investment, and therefore SBA's, might have been jeopardized if the advance had not been made) the loan was taken up in accordance with the undertaking. Technically there was a violation of Section 107.708 of the Regulations and Section 306 of the Act; respondent should have had its stockholders make the advance in the first instance upon the understanding that respondent would take it up only upon SBA approval, since the need for action was urgent and immediate SBA approval was impossible. But respondent did "divest" itself of the overline before the proceeding was commenced pursuant to the undertakings which it had received as a condition to its making the loan. For the reasons set forth above in connection with Count IV, *a fortiori* in view of the prior undertaking obtained from respondent's directors, an order to cease and desist is not necessary or appropriate under the circumstances, and respondent's ephemeral violation was not willful.

The SBA's demand, set forth in its letter of August 29, 1966, that respondent submit a plan to reduce its

investment in Ridgecrest "to not more than the 20% limitation imposed by Section 107.708(a) of the Regulations," ignores the approval theretofore given to exceed such limitation by $20,675, and was therefore improper. An agency cannot, in the absence of newly discovered facts and the like, repudiate its ruling to a licensee's damage where the licensee has acted in justifiable reliance on the ruling. *Chapman v. El Paso Gas Co.*, 204 F. 2d 46 (D.C. 1953). Further, the SBA's demand fails to take cognizance of respondent's written proposal, then pending and not officially acknowledged, to increase its capitalization, which would have eliminated the unapproved as well as the approved Ridgecrest overline.

Proposed findings and conclusions.

Findings and conclusions proposed by the parties have been incorporated herein to the extent that they are found to be material and supported by the record, and are otherwise denied.

Ultimate conclusions and order.

Upon the record in this proceeding it is concluded and found that:

1. Respondent, Electronic Systems Investment Corporation, did not violate the provisions of Section 107.716 of the SBA Regulations in connection with the financing of Cablevision of Fredericksburg, Inc., as alleged in Count I of the Order to Show Cause herein dated September 21, 1966.

2. Respondent did not violate the provisions of Section 107.716 of the SBA Regulations in connection with the financing of Famor, Inc., as alleged in Count II of the said Order to Show Cause.

3. Respondent violated Section 107.716 of the SBA Regulations in connection with the financing of Technical Animations, Inc. as alleged in Count III of the said Order to Show Cause: however, said violation was neither willful nor repetitive; no conflict of interest existed or now exists

with respect to such financing which might be detrimental to any small business concern, to any small business investment company, to the shareholders of either, or to the purposes of the Act; there is no continuing violation of the Act or regulations or of the policy of either; and the divestiture pursuant to order of the SBA of respondent's existing investment in the stock of Technical Animations, Inc., is unnecessary and unwarranted.

4. Respondent violated Section 306 of the Act and Section 107.708 of the SBA Regulations, as alleged in Count IV of the said Order to Show Cause, in connection with financing of Cablevision of Fredericksburg, Inc., through the granting of a loan which, together with prior financing, exceeded the amount of financing of such enterprise which was permissible without SBA approval, which approval was not obtained; but said violation was neither willful nor repetitive, and has been cured by elimination of the amount of financing in excess of the amount thereof permissible without approval.

5. Respondent violated Section 306 of the Act and Section 107.708 of the SBA Regulations, as alleged in Count V of the said Order to Show Cause, in connection with the financing of Ridgecrest Condominium Corporation through the granting of a loan which, together with prior financing, exceeded the amount of financing of such enterprise which was permissible without SBA approval, which approval was not obtained; but said violation was neither willful nor repetitive, and was cured prior to the commencement of this proceeding, pursuant to commitments obtained by respondent prior to the granting of said loan, by elimination of the amount of financing in excess of the aggregate amount thereof duly approved by SBA.

6. The entry of an order requiring said respondent to cease and desist from continuing to violate the Act and Regulations, suspending its license, or ordering respondent to take or refrain from taking any action to ensure compliance with the Act and Regulations, is not warranted or appropriate in the circumstances.

Wherefore, it is Ordered that the Order to Show Cause herein dated September 21, 1966, be and the same hereby is dismissed.

WALTER T. SOUTHWORTH,
Hearing Examiner.

Dated: June 22, 1967

APPENDIX C

UNITED STATES OF AMERICA

Before The

Small Business Administration

Docket No. 67-30

In the Matter of:

Electronic Systems Investment Corporation

License No. 03/04-0048

OPINION — CEASE AND DESIST AND SUSPENSION ORDER

The Administrator having granted approval of the Petition of Counsel for the Small Business Administration for Review of Initial Decision of the Hearing Examiner which dismissed the Order to Show Cause, filed September 21, 1966 has reviewed the Record and finds:

1. The Respondent was licensed by the Small Business Administration May 14, 1964.

2. On August 15, 1964, the Respondent initially acquired through the purchase of debentures and common stock of Cablevision of Fredericksburg, Inc. ("Cablevision") an equity in the amount of $59,400. (T. pp. 20-21). In April, 1965, Respondent made a loan of $34,800 to Cablevision which made Respondent's total financing of Cablevision $94,200. This financing without SBA approval violated Section 107.703 of the SBA Regulations and Section 306 of the Small Business Investment Act.

3. Respondent made two loans to Technical Animations, Inc. ("TAI"), and one investment in common stock of "TAI" (T. P. 40 EX. Nos. 6, 7). At the time of each

of these financings George Bookbinder was a director of TAI and president director and owner of 44 per cent of the outstanding stock of Respondent. (ID. p. 34; see also T. pp. 16, 40-42, 164, 165, 245; Ans. Par. No. 11; G. Ex. Nos. 2, 6 and 7). Although required to do so under Section 107.716 of the Regulations, Respondent neither sought nor received prior written approval from SBA for these transactions. (ID. p. 35; T. p. 42)

4. The "TAI" financing violated Section 107.716 of the SBA Regulations and a conflict of interest still exists with respect to this financing, as Bookbinder is still a director of "TAI". (T. pp. 41, 164-165). The Hearing Examiner erred in finding that the prohibited financing to Technical Animations, Inc. is not a continuing violation. Respondent is not permitted under the regulation cited supra to lend to a single small business concern an amount in excess of 20% of its statutory capital and surplus without SBA approval. As the statutory capital and surplus of Respondent was $301,000, it could finance a single small business concern in an amount not to exceed $60,200. (T. pp. 33, 34). Respondent neither requested nor received permission from SBA to make such excess financing. (T. p. 37)

5. Respondent made financings to Ridgecrest Condominum Corporation (Ridgecrest). The total financing outstanding to this small business in April, 1966, was in the amount of $80,675. The Respondent has requested approval from the Agency for that portion of the financing made in excess of the permissible limitation of $60,200, and such request was granted. (T. pp. 43, 44, 195). Then the Respondent made an additional loan of $10,000 to Ridgecrest without asking SBA's approval. (T. p. 37). The Hearing Examiner determined this to be a violation (ID 44). I concur in that finding but that the Hearing Examiner erred in not issuing a Cease and Desist Order with respect to this illegal financing.

Discussion

The Small Business Investment Act of 1958, as amended, provides in Section 309 (b) that the Administration may revoke or suspend a license where a licensee "has not complied with any provision of this Act or any regulation issued pursuant thereto," and further "that the Administration may order such licensee to cease and desist from such action or failure to act." This broad authority bears neither an expressed nor implied limitation. The legislative history indicates the Congressional intent that it be unlimited. As stated in the U.S. Senate Report No. 801, 87th Congress, First Session, Small Business Investment Act Amendments of 1961, August 28, 1961, on page 7, where it states that the bill containing Section 309 of the Act authorizes the Agency "to issue cease and desist orders to prevent repetition of violations of the act or regulations."

Again, the Legislative history supports the authority of the Administration to issue a cease and desist order, under such circumstances as present in this case. The examiner was proper to dismiss the violation as being of technical nature. The same Report No. 801, page 6 states, ". . . , an infraction of this type must not be disregarded because, in the aggregate, such violations represent a threat to the success of the small business investment program."

The past as well as the present conduct of the Respondent warrants the issuance of such an Order. For a two-year period the Respondent has flaunted that Act and Regulations. Even at the present time, the Respondent is in violation of Section 107.716 of the Regulations in that a conflict of interest still exists, as one man is a director of TAI and a 44% stockholder of Respondent.

Upon the record in this proceeding it is concluded that:

1. Respondent, Electronic System Investment Corporation, did violate the provisions of Section 107.716 of the SBA Regulations which require that a small business investment company limits its investments in any single small business concern to an amount not

in excess of 20% of the combined statutory capital and surplus with the financings to Cablevision. (I.D. p. 44; Count IV of Order to Show Cause). As stated in *Marlene's, Inc. v. Federal Trade Commission*, 7 Cir., 216 F. 2nd 556, 559 "that discontinuance of an unlawful practice of itself does not necessarily preclude the issuance of a cease and desist order is so well settled as to preclude further argument."

2. Respondent violated Section 107.716 of the SBA Regulations and Section 309 of the Small Business Investment Act in connection with the illegal financing of TAI. Mr. Bookbinder who owns 44% of the stock of the Respondent continues to serve as a Director of TAI and the Hearing Examiner erred in failing to find this to be a continuing violation.

3. Respondent violated Section 306 of the Act and Section 107.718 of the SBA Regulations when it granted a loan to Ridgecrest Condominium Corporation which together with prior financing exceeds the total financing of a single small business permissible without SBA approval. This violation was cured prior to the commencement of this proceeding but, as the Second Circuit of Court of Appeals stated in *Deer v. F.T.C.*, 2 Cir. 152 F. 2nd 65, "the Commission has broad discretion to determine whether such an order is needed to prevent resumption of the unlawful practice."

4. The issuing of an order requiring Respondent to cease and desist from continuing violations of the Act and Regulations and suspension of its licenses and ordering Respondent to take specific action to insure compliance with the Act and Regulations is warranted and appropriate under the circumstances. The pattern of behavior by Respondent and the series of violations wilfully committed assures the propriety of its issuance by the Administrator. As the Court said in *Goodman v. Bensen*, "One who intentionally does prohibited act irrespective of evil motive or in reliance on erroneous advice, or who acts with careless disregard of statutory requirement, is guilty of wilful

violation and cannot invoke section of Administrative Procedure Act dealing with imposition of sanctions."

5. As stated in *Coleman Capital Corporation v. Small Business Administration* opinion of December 26, 1967: "it is well established that administrative agencies are vested with a wide discretion in fashioning orders and formulating sanctions adequate to prevent repetition of the violations committed. *Federal Trade Comm'n v. Broch & Co.*, 368 U.S. 360, 364 (1962)."

CONCLUSIONS

A. The Hearing Examiner erred in concluding that there was a non-continuing and insubstantial violation involved with respect to the proven illegal self-dealing financing to TAI, so as to preclude the issuance of a Cease and Desist and Suspension Order against the Respondent.

B. The Hearing Examiner erred in concluding that the issuance of a Cease and Desist Order was not warranted with respect to the proven illegal overline financings to Cablevision and Ridgecrest on the ground that the violations had been terminated.

ORDER

In view of the foregoing findings and conclusions the initial decision of the Hearing Examiner is reversed, the Exceptions of Counsel for SBA are granted.

AND IT IS HEREBY ORDERED that: the Respondent, ELECTRONIC SYSTEMS INVESTMENT CORPORATION, its officers, employees, agents and representatives, directly or indirectly, shall cease and desist from violating the provisions of Section 306 of the Act and Sections 107.708 and 107.716 of the SBA Regulations.

AND IT IS HEREBY ORDERED that: the Respondent, ELECTRONIC SYSTEMS INVESTMENT CORPORATION, shall, within sixty days (60) after the effective date of this Order, divest from its portfolio all of its financings to TECHNICAL ANIMATIONS, INC.

IT IS FURTHER ORDERED that the license of the Respondent, ELECTRONIC SYSTEMS INVESTMENT CORPORATION, be suspended, and the suspension to remain in effect until the Respondent divests the entire financing to TECHNICAL ANIMATIONS, INC., from its portfolio. While the Respondent's license is suspended, it shall not operate as a small business investment company nor shall it receive privileges of a complaint Licensee. This Order shall not prohibit ELECTRONIC SYSTEMS INVESTMENT CORPORATION from maintaining its present operational overhead and making collection upon debts due said Licensee.

IT IS FURTHER ORDERED that the Respondent, ELECTRONIC SYSTEMS INVESTMENT CORPORATION, within sixty days (60) after the effective date of this Order submit to the Small Business Administration a detailed written report of its compliance with the provisions of this Order.

ROBERT C. MOOT,

Administrator.

Dated: February 5, 1968

APPENDIX D

United States of America
Before The
Small Business Administration

Docket No. 67-30

In the matter of
Electronics Systems Investment Corporation
License No. 03/04-0048

ORDER TO SHOW CAUSE

The Small Business Administration, having reason to believe that the above-captioned corporate respondent has violated the provisions of Section 306 of the Small Business Investment Act of 1958, as amended ("Act") (15 U.S.C. §686), and Sections 107.708 and 107.716 of the Regulations (13 C.F.R. §§107.708 and 107.716) promulgated in accordance with Section 308(c) of the Act (15 U.S.C. §687(c)), hereby issues its order to show cause, stating its charges with respect thereto as follows:

Count I

Paragraph One: Respondent, Electronic Systems Investment Corporation, is a corporation organized and doing business under and by virtue of the laws of the State of Maryland. Its place of business is located at 4321 Hartwick Avenue, College Park, Maryland.

Paragraph Two: Respondent is duly licensed as a small business investment company under the Act (15 U.S.C. §661 *et seq.*). Said license is in full force and effect.

Paragraph Three: Section 107.716 of the Regulations (13 C.F.R. 107.716) provides, *inter alia*, that without prior written approval of the Small Business Administration, a Licen-

see shall not provide financing to any small concern in which an officer or director or a beneficial owner of 10 or more percent of the Licensee's stock, or his close relative, is an officer or director or owns or controls ten or more percent of the stock of such small concern.

Paragraph Four: On or about August 15, 1964, the Respondent provided financing to Cablevision of Fredericksburg, Inc., by purchasing debentures in the amount of $54,000, and 1,080 shares of common stock of Cablevision of Fredericksburg, Inc., at $5.00 a share for a total investment of $59,400. Prior written approval of said financing was not requested by the Respondent nor granted by the Small Business Administration.

Paragraph Five: At the time of the transactions as set forth in the Paragraph Four above, Henry M. Kannee was an officer and director of Cablevision of Fredericksburg, Inc.

Paragraph Six: At the time of the transactions as set forth in the Paragraph Four above, Henry M. Kannee was the secretary-treasurer, director and holder of forty-four percent of the stock of the Respondent.

Paragraph Seven: At the time of the transactions as set forth in the Paragraph Four above, the wife of Henry M. Kannee and her sister were the owners of approximately 600 shares of the stock of Cablevision of Fredericksburg, Inc., said shares representing in excess of 10 percent of the outstanding shares of the stock of Cablevision of Fredericksburg, Inc.

Paragraph Eight: Such financing by the Respondent as set forth in the Paragraph Four above, constitutes a violation of the provisions of Section 107.716 of the Regulations (13 C.F.R. 107.716) in that no prior approval was requested nor granted and at the time of the transactions, Henry M. Kannee was an officer and director of Cablevision of Fredericksburg, Inc., and at the same time he was the secretary-treasurer, director and holder of forty-four percent of the stock of the Respondent, and further, in that his wife and

her sister owned in excess of ten percent of the outstanding stock of Cablevision of Fredericksburg, Inc.

Count II

Paragraph Nine: The averments of Paragraphs One, Two and Three above are incorporated herein and made a part hereof as if fully set forth.

Paragraph Ten: On or about June 1, 1963, the Respondent provided financing to Famor, Inc., by making a five year loan of $60,000 to Famor, Inc. Prior written approval of said financing was not requested by the Respondent nor granted by the Small Business Administration.

Paragraph Eleven: At the time of the transaction as set forth in Paragraph Ten above, Henry M. Kannee was a director of Famor, Inc.

Paragraph Twelve: At the time of the transaction as set forth in Paragraph Ten above, Henry M. Kannee was the secretary-treasurer, director and the holder of forty-four percent of the stock of the Respondent.

Paragraph Thirteen: Such financing by the Respondent as set forth in Paragraph Ten above constitutes a violation of the provisions of Section 107.716 of the Regulations (13 C.F.R. 107.716) in that no prior approval was requested nor granted, and at the time of the financing, Henry M. Kannee was a director of Famor, Inc., and at the time he was the secretary-treasurer, director and the holder of forty-four percent of the stock of the Respondent.

Count III

Paragraph Fourteen: The averments of Paragraph One, Two and Three above are incorporated herein and made a part hereof as if fully set forth.

Paragraph Fifteen: The Respondent provided financing to Technical Animations, Inc., in that the Respondent made a $4,000 loan on May 20, 1965, to Technical Animations, Inc., a $11,000 loan on June 8, 1965, to Technical Animations, Inc., and made an investment of approximately $66,000 in

the common stock of Technical Animations, Inc., between December 9, 1965, and January 18, 1966. Prior written approvals of said financings were not requested by the Respondent nor granted by the Small Business Administration.

Paragraph Sixteen: At the times of the various financings as set forth in Paragraph Fifteen above, George H. Bookbinder was a director of Technical Animations, Inc.

Paragraph Seventeen: At the times of the various financings as set forth in Paragraph Fifteen above, George H. Bookbinder was the president, director and forty-four percent stockholder of the Respondent.

Paragraph Eighteen: Such financings by the Respondent as set forth in Paragraph Fifteen above constitute a violation of the provisions of Section 107.716 of the Regulations (13 C.F.R. 107.716) in that no prior approvals were requested nor granted and at the times of the transactions, George H. Bookbinder was a director of Technical Animations, Inc., and the president, director, and forty-four percent stockholder of the Respondent.

Count IV

Paragraph Nineteen: The averments of Paragraph One and Two above are incorporated herein and made a part hereof as if fully set forth.

Paragraph Twenty: Section 306 of the Act (15 U.S.C. §686) and Section 107.708 of the Regulations promulgated thereunder (13 C.F.R. §107.708), provide that without prior written approval of the Small Business Administration, the aggregate amount of funds loaned to, or invested in equity securities of, any small business concern shall not exceed twenty percent of the combined paid-in capital and paid-in surplus of the Licensee, to include for this purpose the proceeds of subordinated debentures purchased by the Small Business Administration pursuant to Section 302 of the Act (15 U.S.C. §682).

Paragraph Twenty-One: As of March 31, 1966, the statutory capital of the Respondent totaled $301,000 as shown on

Respondent's financial report for the period ending March 31, 1966, which was furnished to the Small Business Administration by the Respondent.

Paragraph Twenty-Two: As of March 31, 1966, the Respondent had outstanding loans to and investments in Cablevision of Fredericksburg, Inc., a small business concern, totaling $94,200, as reported by the Respondent to the Small Business Administration in its financial report for the period ending March 31, 1966. Prior written approval of said financing was not requested, nor granted by the Small Business Administration.

Paragraph Twenty-Three: Such financing by the Respondent as set forth in Paragraph Twenty-Two above constitutes violations of Section 306 of the Act (15 U.S.C. §686) and Section 107.708 of the Regulations promulgated thereunder (13 C.F.R. §107.708) in that the loans and investments to Cablevision of Fredericksburg, Inc., by the Respondent exceed the permissible maximum of $60,200.

Count V

Paragraph Twenty-Four: The averments of Paragraphs One, Two and Twenty above are incorporated herein and made a part hereof as if fully set forth.

Paragraph Twenty-Five: As of March 31, 1966, the Respondent has outstanding loans to and investments in Ridgecrest Condominium Corporation, a small business concern, totaling $80,675, as reported by the Respondent to the Small Business Administration in its financial report for the period ending March 31, 1966. Request for approval for that portion of the financing in excess of the maximum permissible investment was made by the Respondent and such request was granted by the Small Business Administration on or about April 14, 1966.

Paragraph Twenty-Six: Subsequent to March 31, 1966, the Respondent has made an additional loan to Ridgecrest Condominium Corporation in the amount of $10,000.00. Prior written approval of said financing was not requested

by the Respondent, nor granted by the Small Business Administration.

Paragraph Twenty-Seven: Such financing by the Respondent as set forth in Paragraph Twenty-Six above constitutes violations of Section 306 of the Act (15 U.S.C. §686) and Section 107.708 of the Regulations promulgated thereunder (13 C.F.R. §107.708) in that the loans to and investments in Ridgecrest Condominium Corporation by the Respondent exceed the approved limit.

Paragraph Twenty-Eight: By letter, dated August 29, 1966, the Small Business Administration notified the Respondent of its failure to operate within the purview of the Act and Regulations thereunder with respect to the various financings as set forth in Paragraphs Four, Ten, Fifteen, Twenty-Two, Twenty-Six above. Further, the letter requested corrective action to be taken within fifteen days of receipt thereof. Respondent has failed to comply within the fifteen days of receipt of said letter and has still failed to do so.

Now Therefore, pursuant to Section 309(c) of the Act (15 U.S.C. §687a(c)) and Section 109.4 of the Regulations (13 C.F.R. §109.4), the respondent is ordered to show cause, if any it has, why an Order should not be issued determining that the respondent has violated Section 306 of the Act (15 U.S.C. §686) and Sections 107.708 and 107.716 of the Regulations (13 C.F.R. §§107.708 and 107.716), and requiring said Licensee to cease and desist from continuing to violate the Act and the Regulations, suspending its license, and for such other and further relief as shall be just and proper based on such facts as are properly a part of the record in this matter.

NOTICE

You are hereby notified that opportunity is afforded you to file with the Small Business Administration an answer to this order to show cause on or before the thirtieth (30th) day after service of it upon you. Such answer shall contain a concise statement of the facts constituting the grounds of defense and a specific admission, denial or

explanation of each fact alleged in the order to show cause or, if respondent is without knowledge thereof, a statement to that effect.

If respondent elects not to contest the allegations of fact set forth in the order to show cause, the answer shall consist of a statement that respondent admits all material allegations to be true. Such an answer shall constitute a waiver of hearings as to facts so alleged, and an initial decision containing appropriate findings and conclusions and an appropriate order disposing of the proceeding shall be issued by the hearing examiner. In such answer respondent may, however, reserve the right to submit proposed findings and conclusions and the right to petition for review under Section 109.21 of the Regulations promulgated by the Small Business Administration.

The failure of the respondent to file an answer to the order to show cause within the time provided shall be deemed to constitute a waiver of its right to appear and to authorize the Examiner, without further notice to respondent, to find the facts to be as alleged in the order to show cause and to enter an initial decision containing such findings, appropriate conclusions and order.

You are hereby notified that a hearing in this matter shall be held at the Small Business Administration, Room 113, 811 Vermont Avenue, N.W., Washington, D. C., 20416, on the 22nd day of November 1966, at 10:00 o'clock.

Dated this the 21st day of September 1966.

BERNARD L. BOUTIN,

Administrator.

APPENDIX E

A. Excerpts From The Small Business Investment Act of 1958, as Amended 15 U.S.C. Sec. 661 et seq.

Section 306 – *Aggregate Limitations.*

Without the approval of the Administration, the aggregate amount of obligations and securities acquired and for which commitments may be issued by any small business company under the provisions of this Act for any single enterprise shall not exceed 20 per centum of the combined capital and surplus of such small business investment company authorized by this Act.

Section 309–*Revocation and Suspension of Licenses: Cease and Desist Orders.*

(a) A license may be revoked or suspended by the Administration–

(1) for false statements knowingly made in any written statement required under this title, or under any regulation issued under this title by the Administration;

(2) if any written statement required under this title, or under any regulation issued under this title by the Administration, fails to state a material fact necessary in order to make the statement not misleading in the light of the circumstances under which the statement was made;

(3) for willful or repeated violation of, or willful or repeated failure to observe, any provision of this Act;

(4) for willful or repeated violation of or willful or repeated failure to observe, any rule or regulation of the Administration authorized by this Act; or

(5) for violation of, or failure to observe, any cease and desist order issued by the Administration under this section.

(b) Where a licensee or any other person has not complied with any provision of this Act, or of any regulation issued pursuant thereto by the Administration, or is engaging or is about to engage in any acts or practices which constitute or will constitute a violation of such Act or regulation, the Administration may order such licensee or other person to cease and desist from such action or to refrain from such action or to refrain from such action as the Administration deems necessary to insure compliance with the Act and the regulations. The Administration may also suspend the license of a licensee, against whom an order has been issued, until such licensee complies with such order.

(c) Before revoking or suspending a license pursuant to subsection (a), or issuing a cease and desist order pursuant to subsection (b), the Administration shall serve upon the licensee and any other person involved an order to show cause why an order revoking or suspending the license or a cease and desist order should not be issued. Any such order to show cause shall contain a statement of the matters of fact and law asserted by the Administration and the legal authority and jurisdiction under which a hearing is to be held, and shall set forth that a hearing will be held before the Administration at a time and place stated in the order. If after hearing, or a waiver thereof, the Administration determines on the record that an order revoking or suspending the license or a cease and desist order should issue, it shall promptly issue such order, which shall include a statement of the findings of the Administration and the grounds and reasons therefor and specify the effective date of the order, and shall cause the order to be served on the licensee and any other person involved.

(f) If any Licensee or other person against which or against whom an order is issued under this section fails to obey the order, the Administration may apply to the United States court of appeals, within the circuit where the licensee has its principal place of business, for the enforcement of the

order and shall file a transcript of the record upon which the order complained of was entered . . .

B. Excerpts from SBA Rules and Regulations

Section 107.708–*Investment and loan limits.*

(a) *Size of investments and loans.*

Without the prior written approval of SBA, the aggregate amount of funds loaned to, or invested in Equity Securities of, any single small business concern, or for which commitments may be made, shall not exceed twenty percent of the combined paid-in capital and paid-in surplus of any Licensee (including in such Licensee's capital and surplus the outstanding amount of any SBA loans and commitments under Sec. 107.301).

Section 107.716–*Conflicts of Interest.* (As in effect from February 15, 1965 to date)

(a) General. Self-dealing to the prejudice of SBA, small business concerns financed by a Licensee, or shareholders of a Licensee, is prohibited.

(b) Persons or concerns connected with the Licensee. Without the prior written approval of SBA, a Licensee shall not, directly or indirectly, provide financing to:

(1) An officer, director, or investment adviser of such Licensee, or any person or firm regularly serving such Licensee in the capacity of attorney-at-law; or

(2) Any person or entity which owns or controls, directly or indirectly, 10 or more percent of the stock of such Licensee; . . .

* * * * * *

(5) Any close relative (i.e., ancestor; lineal descendant; brother or sister, by the whole or half blood, and lineal

descendants of either; daughter-in-law, brother-in-law or sister-in-law) of any person described in subparagraphs (1) and (2) of this paragraph; . . .

* * * * * *

(7) For the purpose of this paragraph, any person or entity which has held any of the positions or relationships described in subparagraphs (1) through (6) of this paragraph within six months prior to the date of financing, or which holds any such positions or relationships within six months after the date of financing shall be deemed to have such position or relationship as of the date of financing.

* * * * * *

(h) *Protection of investment.* Nothing herein contained is intended to preclude a Licensee from permitting an officer, employee, or representative from serving as an officer, director, or in any other capacity in the management of a small business concern for the purpose of protecting its investment in or loan to such concern.

C. Excerpts From
Administrative Procedure Act now found in 5 U.S.C.
500 *et seq* provides in part as follows:

Sec. 557 (c) Before a recommended, initial, or tentative decision, or a decision on agency review of the decision of subordinate employees, the parties are entitled to a reasonable opportunity to submit for the consideration of the employees participating in the decisions–

(1) proposed findings and conclusions; or

(2) exceptions to the decisions or recommended decisions of subordinate employees or to tentative agency decisions; and

(3) supporting reasons for the exceptions or proposed findings or conclusions.

The record shall show the ruling on each finding, conclusion, or exception presented. All decisions including initial, recommended, and tentative decisions, are a part of the record and shall include a statement of–

(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and

(B) the appropriate rule, order, sanction, relief, or denial thereof.

Sec. 558 (c) When application is made for a license required by law, the agency, with due regard for the rights and privileges of all the interested parties or adversely affected persons and within a reasonable time, shall set and complete proceedings required to be conducted in accordance with sections 556 and 557 of this title or other proceedings required by law and shall make its decision. Except in cases of willfulness or those in which public health, interest, or safety requires otherwise, the withdrawal, suspension, revocation, or annulment of a license is lawful only if, before the institution of agency proceedings therefor, the licensee has been given–

(1) notice by the agency in writing of the facts or conduct which may warrant the action; and

(2) opportunity to demonstrate or achieve compliance with all lawful requirements.

When the licensee has made timely and sufficient application for a renewal or a new license in accordance with agency rules, a license with reference to an activity of a continuing nature does not expire until the application has been finally determined by the agency.

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1183

ELECTRONIC SYSTEMS INVESTMENT CORPORATION, PETITIONER

v.

SMALL BUSINESS ADMINISTRATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR RESPONDENT IN OPPOSITION

On September 21, 1966, the Small Business Administration (SBA) issued an Order to Show Cause why petitioner, a small business investment company licensed under the Small Business Investment Act (15 U.S.C. 661 *et seq.*), should not be ordered to cease and desist from violating Sections 306 and 312 of the Act (15 U.S.C. 686, 687d), and Sections 107.708 and 107.716 of the SBA's implementing regulations,[1] and

[1] 13 C.F.R. 107.708 (and 15 U.S.C. 686) prohibits a small business investment company (SBIC) from extending financ-

why an order should not issue suspending petitioner's license under the Act and providing other appropriate relief (Pet. App. D-1). Specifically, petitioner was charged, *inter alia*, with (a) extending financing to Technical Animations, Inc. at a time when its own president and 44-percent stockholder was also a director of that company, and (b) without obtaining prior SBA approval, extending financing to two other corporations, each in an amount greater than 20 percent of petitioner's paid-in capital and surplus.

After a hearing on these charges, the SBA ultimately determined that petitioner had violated the aforementioned regulations. Accordingly, an order was entered on February 5, 1968 (Pet. App. C-1) directing petitioner to cease and desist from violating the Act and regulations. The order also directed divestiture of the illegal investments in Technical and suspended petitioner's license under the Act pending compliance with the order (Pet. App. C-5 - C-6).

Petitioner thereafter applied to the Court of Appeals for the Fourth Circuit, pursuant to 15 U.S.C. 687a(e), to have the Administration's order set aside. In a *per curiam* opinion, that court denied the petition, ruling that the challenged order was supported by substantial evidence and was not contrary to law (Pet. App. A-2).

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ing in an amount greater that 20 percent of its paid-in capital and surplus to any one small business concern. 13 C.F.R. 107.716, a conflict of interest provision implementing 15 U.S.C. 687d, prohibits, in the absence of prior SBA approval, an SBIC from extending financing to a company which has, *inter alia*, a common director with the SBIC.

1. The thrust of petitioner's argument is nothing more than a claim that the court of appeals erred in ruling that the SBA order was supported by substantial evidence. It is settled, however, that the question of the substantiality of supporting evidence in such a case is one which "Congress has placed in the keeping of the Court of Appeals." *Universal Camera Corp.* v. *National Labor Relations Board*, 340 U.S. 474, 491; *Federal Trade Commission* v. *Standard Oil Co.*, 355 U.S. 396, 401. Moreover, there is nothing in the record to suggest that the court below failed to apprehend the controlling legal principles or to assess properly the substantiality of the evidence in light of those standards.

2. Petitioner also calls into question the SBA's choice of remedy, contending that it was "drastic" for the Administration, after ordering it to divest itself of all investments in Technical, to suspend its license temporarily until divestiture had been effected (Pet. 12-15). However, this course of action is expressly authorized, in clear terms, in 15 U.S.C. 687a (b). That section provides that when a licensee has not complied with the provisions of the Act or the Administration's regulations, in addition to issuing a cease and desist order and requiring the licensee to take such other action as would insure compliance with the Act's provisions, the Administration "may also suspend the license of such licensee until the licensee has complied with such order." Moreover, an administrative agency has wide discretion in selecting the sanction it views as necessary and appropriate in carrying out its statutory responsibilities in a particular case. Judicial review here "extends no further

than to ascertain whether the [agency] made an allowable judgment in its choice of the remedy." *Jacob Siegel Co.* v. *Federal Trade Commission*, 327 U.S. 608, 611-612; see also *Federal Trade Commission* v. *Henry Broch & Co.*, 368 U.S. 360, 364; *American Power Co.* v. *Securities & Exchange Commission*, 329 U.S. 90. 118. Here the agency choice of remedy was plainly a permissible one,[2] and there was no showing of any abuse of administrative discretion.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

APRIL 1969.

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[2] Noting that petitioner had been violating the Act for over two years and that the SBA had sought corrective action for many months, the agency properly took petitioner's "pattern of behavior" and "the series of violations wilfully committed" by it into account in framing its order (Pet. App. C-4). Petitioner moreover continued to engage in these practices while aware that the SBA considered its earlier loans to Technical to be violations of the Act (see Pet. App. C-3 - C-5).

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